



This is a digital copy of a book that was preserved for generations on library shelves before it was carefully scanned by Google as part of a project to make the world's books discoverable online.

It has survived long enough for the copyright to expire and the book to enter the public domain. A public domain book is one that was never subject to copyright or whose legal copyright term has expired. Whether a book is in the public domain may vary country to country. Public domain books are our gateways to the past, representing a wealth of history, culture and knowledge that's often difficult to discover.

Marks, notations and other marginalia present in the original volume will appear in this file - a reminder of this book's long journey from the publisher to a library and finally to you.

Usage guidelines

Google is proud to partner with libraries to digitize public domain materials and make them widely accessible. Public domain books belong to the public and we are merely their custodians. Nevertheless, this work is expensive, so in order to keep providing this resource, we have taken steps to prevent abuse by commercial parties, including placing technical restrictions on automated querying.

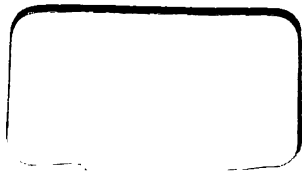
We also ask that you:

- + *Make non-commercial use of the files* We designed Google Book Search for use by individuals, and we request that you use these files for personal, non-commercial purposes.
- + *Refrain from automated querying* Do not send automated queries of any sort to Google's system: If you are conducting research on machine translation, optical character recognition or other areas where access to a large amount of text is helpful, please contact us. We encourage the use of public domain materials for these purposes and may be able to help.
- + *Maintain attribution* The Google "watermark" you see on each file is essential for informing people about this project and helping them find additional materials through Google Book Search. Please do not remove it.
- + *Keep it legal* Whatever your use, remember that you are responsible for ensuring that what you are doing is legal. Do not assume that just because we believe a book is in the public domain for users in the United States, that the work is also in the public domain for users in other countries. Whether a book is still in copyright varies from country to country, and we can't offer guidance on whether any specific use of any specific book is allowed. Please do not assume that a book's appearance in Google Book Search means it can be used in any manner anywhere in the world. Copyright infringement liability can be quite severe.

About Google Book Search

Google's mission is to organize the world's information and to make it universally accessible and useful. Google Book Search helps readers discover the world's books while helping authors and publishers reach new audiences. You can search through the full text of this book on the web at <http://books.google.com/>

STETSON-BYRNE-CRAVATH
WICKERSHAM-MONTAGUE
COLEMAN-GUTHRIE



CT
AS2
TG
copy 1

**LECTURES DELIVERED BEFORE THE ASSOCIATION
OF THE BAR OF THE CITY OF
NEW YORK, 1916**

**SOME LEGAL PHASES OF CORPORATE
FINANCING, REORGANIZATION
AND REGULATION**



THE MACMILLAN COMPANY
NEW YORK • BOSTON • CHICAGO • DALLAS
ATLANTA • SAN FRANCISCO

MACMILLAN & CO., LIMITED
LONDON • BOMBAY • CALCUTTA
MELBOURNE

THE MACMILLAN CO. OF CANADA, LTD.
TORONTO

**SOME LEGAL PHASES OF CORPORATE
FINANCING, REORGANIZATION
AND REGULATION**

BY

FRANCIS LYNDE STETSON

JAMES BYRNE

PAUL D. CRAVATH

GEORGE W. WICKERSHAM

GILBERT H. MONTAGUE

GEORGE S. COLEMAN

WILLIAM D. GUTHRIE

UNIVERSITY OF MICHIGAN

New York

THE MACMILLAN COMPANY

1917

All rights reserved

COPYRIGHT, 1917,
BY THE MACMILLAN COMPANY.

Set up and electrotyped. Published March, 1917.

237165

YVA301 0803M12

Norwood Press
J. S. Cushing Co. — Berwick & Smith Co.
Norwood, Mass., U.S.A.

CONTENTS

	PAGE
INTRODUCTORY NOTE	vii
PREPARATION OF CORPORATE BONDS, MORTGAGES, COLLATERAL	
TRUSTS, AND DEBENTURE INDENTURES, BY FRANCIS LYNDE	
STETSON	1
FORECLOSURE OF RAILROAD MORTGAGES, BY JAMES BYRNE .	77
REORGANIZATION OF CORPORATIONS, BY PAUL D. CRAVATH .	153
THE SHERMAN ANTI-TRUST LAW, BY GEORGE W. WICKERSHAM	235
THE FEDERAL TRADE COMMISSION AND THE CLAYTON ACT, BY	
GILBERT H. MONTAGUE	275
THE PUBLIC SERVICE COMMISSIONS, BY GEORGE S. COLEMAN .	327
PUBLIC SERVICE COMMISSIONS, BY WILLIAM D. GUTHRIE .	347
INDEX	375
CASES CITED OR DISCUSSED	379

INTRODUCTORY NOTE

THE addresses of which this volume is composed were delivered during the early spring of 1916, at the instance of the Association of the Bar of the City of New York, to audiences drawn from the practicing lawyers of New York City. They excited so much interest, evidenced not only by an unexpectedly large attendance but by repeated and continuing requests for copies of the lectures, that the Executive Committee of the Association has felt justified in permitting their publication.

In the autumn of 1915, the Association decided to offer, periodically, a series of law lectures by especially qualified lawyers upon some particular subject or upon closely related subjects which should, in such degree as might be practicable, afford the general practitioner the benefit of the experience and practical counsel of those who have become expert in the branch of law under discussion. The addresses contained in this book constitute the first series of lectures presented in execution of this purpose. The reader should understand that these papers were not intended for general reading nor even for the instruction of law students, although, doubtless, any one possessing a certain amount of technical knowledge may find in them much that will prove of interest. They were not designed to suggest reforms in law or in judicial procedure, however much or undeniably such reforms may be needed. Nor were they designed to set forth in any comprehensive way the body even of the very special branch of the law with which they are concerned.

They were intended for the practical guidance of practicing lawyers, already familiar with the general principles and rules of practice, in accomplishing specific things in the best and most efficacious ways.

The task of supervising the legal phases of the work of reorganizing and refinancing great corporate enterprises — whether regenerated by complete reorganization or merely reinvigorated by voluntary recapitalization — is performed by a relatively small number of lawyers. Almost every such undertaking requires the investment of new capital, which must be supplied or “underwritten” in advance; for in such an affair the consequences of failure are too serious and the injuries inflicted too nearly permanent to justify risking a fiasco. Moreover, a scheme of reorganization or of financing which cannot be underwritten in advance must, almost certainly, be one which is foredoomed. The dominant figure, therefore, in every such undertaking, is that of the banker and the guiding spirit is the banker’s lawyer. Bankers who are qualified by wealth, experience, and influence to undertake such affairs are few in number; in direct ratio, the membership of what may, not unappropriately, be denominated “the financial bar” is also limited. There are, nevertheless, numerous instances in which lawyers habitually engaged in other branches of practice are called upon to advise clients who are deeply interested in corporate reorganizations, and occasionally such a lawyer finds himself in the rôle of adviser to a reorganization committee, a syndicate of underwriters, or a mortgage trustee. However well grounded in principle or familiar with precedent he may be, however competent to discover by an expenditure of time and labor what should be done and how to do it, any such person must necessarily, for a time at least, be at a loss for that practical guidance which cannot be found in books or decisions. These lectures were designed to serve persons thus situated and, as well, younger members of the profession called on to assist more experienced lawyers in such

matters or ambitious to engage in practice of the sort described.

The Lectures on the Sherman Anti-Trust Law and the Clayton Act discuss important phases of the law of inter-corporate relations that are necessarily involved in any present-day consideration of the financing and reorganization of corporations.

The realization of the plan for courses of lectures of which these addresses form the first instalment was due, in great part, to the zeal and unselfish endeavor of the late Francis C. Huntington, the Chairman of the Special Committee charged with the execution of the plan. Mr. Huntington's untimely death occurred while the lectures for which he had arranged were in process of delivery. In a very real sense this book is, by the very circumstances of its production, dedicated to the memory of that sweet-natured, high-souled, and public-spirited lawyer.

SOME LEGAL PHASES OF CORPORATE FINANCING, REORGANIZATION, AND REGULATION

PREPARATION OF CORPORATE BONDS, MORT- GAGES, COLLATERAL TRUSTS AND DEBENTURE INDENTURES

Papers read February 9 and February 16, 1916, before The Association of the
Bar of the City of New York by Francis Lynde Stetson¹

THE papers to be presented by me in the present series are intended not as treatises, but rather for practical guidance in the preparation and examination of corporate bonds and mortgages, collateral trusts and debenture indentures. They are related to and arise out of the activities of corporations organized for the transaction of business, usually the business of transportation. This evening, after a general introduction, the paper will deal only with the subject of corporate bonds and mortgages and deeds of trust, strictly so called, the consideration of collateral trusts and debentures having been assigned to the evening of February 16th.

The Historical Development of the Corporate Bond and Mortgage

The conditions and objects of the law concerning corporate bonds and mortgages may be presented conveniently as the

¹ At the very outset it is proper that I should state that except for the promised and abundant coöperation of my friend and associate Mr. George H. Gardiner I should have been unable to accept the invitation to read before this Association the papers to which without reserve he has contributed from his large experience.

2 PREPARATION OF CORPORATE BONDS, MORTGAGES

same has been developed in connection with railroad corporations, particularly as created or regulated by the statutes of our own state, to which your attention is first invited.

It is difficult to realize that less than a century has elapsed since the enactment of the first railroad charter in this State, viz., that of the Mohawk & Hudson Railroad Company, incorporated April 17, 1826,¹ to construct and operate a railroad eighteen miles long from Albany to Schenectady. This charter authorized a capital stock not exceeding \$500,000, and reserved to the state the right within five years from completion to take over the railroad at cost and interest. An expenditure in excess of the authorized capital could hardly have been anticipated, for the act contained no grant of power to mortgage. But, as has been usual in later experience, the original estimate of cost proved inadequate; and eight years later acts were passed increasing the stock, and authorizing a mortgage for not more than \$250,000, and also the conversion of the loan into stock at par within two years after the passage of the act. This chapter 39 of 1834 is the earliest New York act in which I have found provisions expressly authorizing a railroad mortgage or the conversion of a loan into stock; but in the next decade the charter of the Hudson River Railroad Company, enacted May 12, 1846,² gave such powers more freely and with much elaboration, subject, however, to the limitations that the \$2,000,000 mortgage thereby authorized should not cover the personal property, should always be \$500,000 less than the paid-up capital stock, and that the whole capital represented by the stock and the bonds should not exceed \$6,000,000.

Just before this time Mr. Charles O'Connor had been arguing before Vice-Chancellor Sandford, with boldness and great subtlety, but unsuccessfully, that such a limitation upon capital constituted a limitation also upon the total amount of property that a corporation might own, and that bonds issued in payment for property, thereby exceeding that amount, were void and

¹ Laws of N. Y. 1826, Chap. 253.

² *Ibid.* 1846, Chap. 216.

unenforcible; in other words, that the power to borrow money and to acquire property must be construed as being confined within the limits of the total authorized capital of the corporation. Had the courts sustained Mr. O'Connor in his contention in February, 1844, in the case of *Barry v. Merchants' Exchange Company*,¹ the history of corporate enterprise in this State would have been very different from what it has been, unless, as the exigencies of events would have required, relief had been obtained from the legislature. The importance of this decision of Vice-Chancellor Sandford, as the first adjudication in this State of the right of a corporation to borrow, even in the absence of express statutory authority, was considered later at length in the luminous and eloquent opinion of Judge Comstock in the great case of *Curtis v. Leavitt*.² The conclusion was there reached "that corporations, along with their specific" powers, take all the reasonable means of execution, all that are "adapted to the end in view," and that it is within the power of corporations generally to issue bonds or notes when no prohibitory or restraining statute is violated and the purpose or occasion of making them is lawful. The establishment of these principles, almost platitudinous now, involved at the outset battles royal between the keenest intellects of this bar, Beardsley, Bidwell, Bronson, B. F. Butler, Cutting, Duer, Hill, William Kent, Lord, Noyes, and O'Connor.

But the adjudicated power to issue bonds or notes did not, without express authority, carry the power also to secure the same by lien or mortgage upon the public franchises of the corporation,³ nor were such franchises ordinarily subject to seizure and sale under execution.⁴ This necessary power to mortgage was granted by the legislature of New York with great hesitation and many limitations, by special acts from time to time up to

¹ 1 Sandf. Ch. (N. Y.) 280-312; 1844.

² 15 N. Y. 1, 51-62; 1857.

³ *Carpenter v. Black Hawk Gold Mining Co.*, 65 N. Y. 43-50; 1875. *Snell v. Chicago*, 152 U. S. 191-199; 1893.

⁴ *Gue v. Tide Water Canal Co.*, 24 How. (U. S.) 257-263; 1860.

4 PREPARATION OF CORPORATE BONDS, MORTGAGES

April 2, 1850, when by the great general railroad law of that year (Chapter 140),¹ which with some enlargements is substantially our present law, there was granted to railroad companies generally power "to mortgage their corporate property and franchises to secure the payment of any debt contracted by the company" for completing, finishing or operating their railroad, with the right to confer on the holders of bonds the right to convert the principal due or owing thereon into stock of the company. Now the mortgaging power has been granted throughout the United States, by statutes which vary so widely and contain so many special restrictions, that no one should address himself to the preparation or approval of a mortgage upon any railroad without first studying carefully the pertinent provisions of law in every state through which the railroad runs. Tedious and even meticulous examination beforehand of the constitution and the statutes, both general and special, of the several states in question, may be rewarded by relief from that particular form of subsequent misery which Tom Moore declared to be Hell, that is, "truth known too late."

From this summary indication of the fundamental legal requirements for a valid corporate mortgage or deed of trust we may proceed to a consideration of such instruments and of the bonds or debentures supposed to be secured by such instruments.

In the year 1825 occurred two events of momentous importance in the subsequent history of the world and of corporate obligations—the opening of George Stephenson's railroad from Darlington to Stockton-on-Tees and of De Witt Clinton's canal from Lake Erie to the Hudson River. Immediately, throughout our Atlantic States, there developed an excited and even frenzied demand both for canals and for railroads. In New York the demand, as in the case of the Mohawk & Hudson and its later connections west to Buffalo, was for competition with the canal, and as in the case of the New York and

¹ Laws of N. Y. 1850, Chap. 140.

Erie Railroad, chartered April 24th, 1832,¹ to run through the southern tier of counties, as compensation to them for the State's canal construction through central New York.² Charters almost without number were followed by preliminary surveys, resulting in disappointments or disasters. Scheme followed scheme defiant of natural conditions or sound finance, and bubbles burst in bankruptcies, until appeals for aid, beyond the inadequate returns from issues of unsecured capital stock, were pressed most urgently upon the State and upon the general public. In 1834, the Baltimore & Ohio Railroad Company obtained from the State of Maryland considerable loans, for the repayment of which it gave back a mortgage upon its railroad, following the example of the New York and Lake Erie Railroad Company, which, in 1833, by mortgaging its railroad to the State of New York, obtained for certain of its stock the guaranty of the State.

But in each case the aid thus obtained proved inadequate, and then came into operation the American form of corporate bonds secured by mortgage upon the railroad property and franchises, involving foreclosure and sale in case of default, after the familiar form of a mortgage on real estate. The first of such mortgages was that of the Baltimore & Ohio Railroad in 1846, and the next, that of the New York and Erie Railroad dated July 1, 1847, to secure \$3,000,000 bonds of which there

¹ The expectations centering upon the New York and Erie Railroad were thus stated in the first number of the *American Railroad Journal*, published January 2, 1832: "With such a Railroad intersected at convenient distances by other railroads running from the Erie Canal and one from Ogdensburgh to Syracuse or Utica almost every county in the State would be brought within twenty-four hours of New York. It would prevent a recurrence of the state of things which now exists in this city. There would not then be, as there now is, thousands of barrels of flour and other kinds of produce in proportion frozen up in canal boats, and in sloops on the Hudson; salt would not be now selling in Albany for two dollars and fifty cents per bushel, and pork at two dollars per hundred for want of salt to save it, while in this city it is worth from five to seven dollars. Coal would not sell here for fifteen or sixteen dollars per ton, . . . as has been the case for two or three weeks past, if railroads were in general use."

² Laws of N. Y. 1832, Chap. 224.

6 PREPARATION OF CORPORATE BONDS, MORTGAGES

are still outstanding \$2,482,000, the time of payment having been extended to 1937. This form of mortgage upon railroad property, involving a foreclosure sale in case of default, is not available to railroad corporations in England. The borrowings of English railroads are upon promissory obligations somewhat similar to our corporate bonds, but which constitute merely a charge upon "the undertaking," or, in other words, upon the income of the property enforceable through the appointment of a receiver.¹ Such obligations are given the general term "debentures." Sir Francis Palmer in his "Company Precedents," traces the term "debentures" from very early times, and concludes that the word admittedly has no technical significance, but that its meaning is to be determined by the popular sense in which it is used. In England, according to Palmer, the term "debenture" seems to comprehend all serial obligations of the corporation, whether or not secured by a charge, and whether or not issued under a trust deed, those issued under a trust deed being generally styled debenture stock. In this country, the term "debentures" has come to mean any class of serial obligations of a corporation not secured by a specific lien upon property.

From the very beginning, and still continuing, the form of the corporate serial obligation and of the mortgage or other instrument pursuant to which such obligations are issued, has been undergoing enlargement because of the development of new requirements by investors. The condition corresponds to that which originally produced the idea of the corporate bond and mortgage, namely, the urgent demand for capital for corporate enterprise, and the necessity of offering to the public a form of security which will satisfy as well as attract purchasers of corporate bonds.

The mortgage of the Baltimore & Ohio, made in October, 1846, to the President of the Company and his successors as

¹ The English and Canadian procedure "takes the place . . . of foreclosure sales in the United States, which in general accomplish substantially the same result with more expense and greater delay."—WAITE, C. J., *Canada Southern Railway Co. v. Gebhard*, 109 U. S. 527, 539; 1883.

Trustees, is interesting, in that it recites that the Company has issued "certificates of debt in which was contained the pledge of the property and funds and stock" of the Company, and that "it has been suggested that the security intended to be given by the Company to the holders of said certificates, and their assigns, would be to them more satisfactorily expressed if there was executed by the said Company an instrument of writing which being duly acknowledged might be recorded as deeds and mortgages are recorded," and thereupon proceeds to grant in trust for the holders of said certificates the property and funds of the Company comprehended in the authority of the statute governing the Company. Except as to the recitals, the mortgage instrument is substantially an ordinary real estate mortgage without covenants. The Baltimore & Ohio issued also various mortgages, including a sterling mortgage running to Baring & Company of London, in 1850, and three later mortgages in 1850 and 1853 to the President of the Company as trustee.

In 1850 and later, various railroads in the South were mortgaged by statute to secure advances made to them by the incorporating State, among which may be mentioned the First Mortgage of the Richmond and Danville Railroad to the Commonwealth of Virginia, made in 1850 to indemnify the State against its indorsement of \$200,000 six per cent bonds of the Railroad Company; the Second Mortgage of the same company to the Board of Public Works of Virginia to secure a loan by the State of \$600,000; a lien upon the Laurens railroad created by the South Carolina statute of 1859; and various liens upon other roads under the Internal Improvement Laws of Tennessee and other states in 1853 and 1854.

In tracing the development of the corporate mortgage from the statutory lien phase it may be advantageous now to resume and continue consideration of the story of the funded debts of the New York and Erie Railroad and its successors. For a long period the managers of that corporation were the pioneers in the gradual expansion of the corporate mortgage from a simple real estate

8 PREPARATION OF CORPORATE BONDS, MORTGAGES

lien to the complex agreements which have become necessary to meet the increasingly exacting demands of the investing public.

The Baltimore & Ohio mortgages are of less interest than the Erie mortgages, inasmuch as the modern form of instrument indicates a development of the Erie mortgages rather than of the Baltimore & Ohio form.¹

Next succeeding the New York and Erie bonds of July 1, 1847, secured by the State lien of 1845, came the Company's so-called "second mortgage," being its first deed of trust, dated March 1, 1849, to John J. Palmer and others as Trustees. This mortgage granted to the trustees of the railroad all the appurtenances of the Company "now owned . . . or which shall hereafter be owned," but subject to the \$3,000,000 lien of the statute of 1845. It will be observed that, even at this early date, there was recognized the necessity of obtaining a lien on the corporate enterprise as a whole, by providing that after-acquired property should be included. The debt to be secured by the mortgage was \$4,000,000, evidenced by 7 per cent bonds, each of one thousand dollars.

The bonds in terms acknowledge the company to be indebted to "John J. Palmer or bearer in the sum of \$1,000, lawful money of the United States, which sum they promise to pay to the said John J. Palmer or bearer," and provided for the payment of the interest semi-annually "on presentation and delivery of the annexed dividend warrants." The bond then proceeds to recite that it is one of the series issued for the extension of the railroad, and that the holder is entitled to the security of the described mortgage. It is of interest to note also that a stock conversion privilege is included as follows:

"The holder of this bond shall be entitled at any time before the first day of March, 1859, to convert the principal sum into the capital stock of the Company at par, on surrendering the bond with the warrants not then due annexed."

¹ The Erie Railroad Company and its predecessors and subsidiaries have issued twenty-seven mortgages now outstanding, of which eight cover the main line.

The mortgage instrument contains about twenty folios. It recites briefly the corporate authority of the mortgagor, and the purpose of the deed, sets forth the form of the bonds in full, grants the mortgaged property in trust to the trustees subject to the prior state statutory lien, contains a covenant of further assurance, and provides that in case of default it shall and may be lawful for the trustees "upon the request in writing of any one of the holders of the bonds on which interest or principal is not fully paid," to enter upon and take possession of the property and to sell the same, and as attorneys of the mortgagor to execute conveyance to the purchaser, and to apply the proceeds of sale to the payment of costs, the satisfaction of the mortgage debt and the rendering of the surplus to the mortgagor or assigns. The mortgage contains also a provision for the filling of vacancies among the trustees. This mortgage was drafted probably by Judge William Kent, then the counsel of the railroad, son of Chancellor Kent, and himself of high authority as a lawyer, conveyancer and judge.

Upon March 1, 1853, the New York and Erie Railroad Company executed its so-called "third mortgage" to James Brown and John Davis, as Trustees. This third mortgage provides for the issue of \$10,000,000 bonds, of which \$4,000,000 were to provide for the payment of an equal amount of bonds secured by the former mortgage of 1849. This seems to have been the inception of the refunding mortgage.

The bond is substantially in the form of the pioneer of 1849, but there appears on the margin the following;

"New York and Erie Railroad Company	
Mortgage Bond No.	\$1000.
This is to certify that the within bond is included in a mortgage on the entire property of the New York and Erie Railroad Company, duly executed to James Brown and John Davis, Trustees, and dated March 1, 1853."	

While the signature of the trustees does not appear to have been required, this is clearly the origin of the certificate of

10 PREPARATION OF CORPORATE BONDS, MORTGAGES

authentication which invariably is placed upon bonds of the present day and is signed by the trustee.

The mortgage itself follows generally the form of the last preceding mortgage.

The so-called "fourth mortgage" of New York and Erie Railroad Company, dated August 15, 1857, was executed to James Brown and John C. Bancroft Davis, as Trustees.

The bond follows the form of the early bond, except that it contains a provision that in case of six months' default in the payment of any of the interest warrants "on the bonds of this issue . . . then the principal of the said bonds shall be due and payable." It provides also for the countersignature of the trustees at the foot of the bond.

The mortgage covers not only the railroad of the company, but also the rights of the company under leases of other railroads. It repeats the provision in the bonds about the acceleration of the maturity of the principal in case of default and contains also provisions setting forth the immunities of the trustees. In text this mortgage is about twice the length of the original mortgage of 1849.

The so-called fifth Erie mortgage, dated June 1, 1858, indicates no further development in form, but it provides for the issue of bonds of \$500 each as well as bonds of \$1000.

Subsequently to the fifth mortgage and in September, 1865, the Erie Railway Company, the successor of the New York and Erie Railroad Company, issued a series of convertible unsecured bonds for the principal amount of £1,000,000 which had no lien upon the property of the Company.

Then there appears the first mortgage of the Company to a corporate trustee, the First Consolidated Mortgage of 1870 from the Erie Railway Company to the Farmers Loan and Trust Company. The mortgage instrument is similar to the preceding one, but the bonds contain three features appearing for the first time. The first is a promise to pay, at the option of the holder, in sterling money at a fixed rate of exchange in-

stead of in United States gold coin. The second is the provision for the registration of the principal sum. The third is the recital that "this bond shall not become obligatory until authenticated by a certificate endorsed hereon signed by the said Trustee," which certificate in terms declared that the bond is one of the bonds secured by the mortgage and that the mortgage was duly recorded.

In 1874 the same company issued its Second Consolidated Mortgage. This mortgage secured not only \$30,000,000 of bonds issuable thereunder, but also \$10,000,000 of convertible bonds issued two years previously. Such provision for securing equally with the mortgage bonds a prior unsecured debt was a new feature in such an instrument; and the bond contains a provision, then novel, reserving to the company the right to redeem the bond before maturity.

Generally, the earliest mortgages ran to a single individual as trustee, although in the case of the New York and Erie Railroad Company from the beginning there were two or more individual trustees. Subsequently it became the general practice to name two or three individuals as trustees. Still later, the individual trustee was superseded customarily by a corporate trustee, and in recent years, to meet the requirements of State statutes calling for a resident trustee, a natural person and citizen of the State oftentimes is joined with a corporate trustee, to which, however, is assigned exclusively all active duties prior to default.

In the earliest mortgages, the trust estate was the real property, appurtenances and equipment of the mortgagor; then leaseholds were added, and still later security interests in other companies. Such security interests were assigned in terms and without delivery to the trustee of the stock and bonds themselves; in other words, by way of mortgage rather than pledge.¹ As an illustration, in the New York, Lake Erie &

¹ *Wilson v. Little*, 2 N. Y. 443; 1850. Story on Bailments, Sections 290-297; 9th Ed., 1878.

12 PREPARATION OF CORPORATE BONDS, MORTGAGES

Western Second Consolidated Mortgage bonds of 1878, the assignment is of "all the estate, right, title and interest of the party of the first part in the following corporations . . . intending hereby to convey . . . all and every right, title and interest of the party of the first part . . . whether as lessee or *as holder of stock or* bonds of the corporations, associations and organizations. . . ."

A later development in this direction was the deposit of the corporate securities with the trustee, thus effecting a perfect pledge of the property so delivered. In some instances, such a pledge of corporate securities was made in addition to and as part of a mortgage on the railroad property, and, in other instances, the pledged property constituted the sole trust estate. An early instance of a pledge as sole security was a mortgage of the New York, Lake Erie & Western Railroad Company of October 1, 1885, to secure its funded coupon bonds, the security being the pledge with the trustee of coupons appertaining to bonds secured by certain prior mortgages. Except for such mortgage lien, the promises of the obligor could not be regarded as constituting collateral security for its subsequent promises.

Other early examples of indentures under which the security was solely corporate bonds and stocks, are the two indentures of the Richmond & West Point Terminal Railway and Warehouse Company, one dated February 1, 1887, and the other dated March 1, 1889, each securing bonds by the pledge with a trust company of a number of parcels of different corporate bonds and stocks. There may be mentioned also a collateral trust mortgage of the Georgia Company made in 1888, securing bonds by the pledge with a trust company of stock of the old Central Railroad & Banking Company of Georgia, and nothing else.

A prominent instance of a mortgage creating a lien on real property and a pledge of corporate securities, was the Consolidated Mortgage of the Northern Pacific Railway Company of 1889, wherein provision was made for delivery to the trustee

of various corporate securities, of which large amounts were held in pledge by the trustee at the time of the foreclosure of the mortgage in 1896. At the present time nearly all large railroad mortgage indentures include pledges of corporate securities in addition to the mortgage lien on the real property and appurtenances.

The panic of 1893 and the hard times ensuing led to defaults under many railroad mortgages, resulting in foreclosure sales followed by comprehensive reorganizations. In most cases such reorganizations involved the issue of long-time bonds of large amounts secured by all-embracing mortgages, and providing particularly for the increase of the initial debt by the issue of additional bonds for refunding and improvement purposes. The mortgages of the great reorganized railroad companies, such as the Southern, the Erie, the Northern Pacific, the Atchison, and the Union Pacific, made from 1894 to 1896, were the result of comprehensive study of such instruments by many counsel, and they established the form of the corporate mortgage now substantially followed.

The foregoing sketch of the development of corporate mortgages, while in no sense exhaustive, is given as affording a useful and perhaps interesting preliminary to the announced subject matter of these papers—the preparation of corporate mortgages, bonds, collateral trusts and debentures, the further discussion in this lecture being devoted to special consideration of corporate bonds and mortgages.

Corporate Bonds and Mortgages

In the treatment of this subject some definitions of terms may be useful. As herein employed, the term “corporate mortgage” is to be understood as referring to a corporate indenture intended to convey real property and appurtenances, and usually franchises, as security for corporate obligations issued or to be issued in series. The term “collateral trust” is limited to conveyances by way of pledge of corporate stocks and

14 PREPARATION OF CORPORATE BONDS, MORTGAGES

bonds with or without other intangible personal property. The term "debentures" is confined to obligations issued under an indenture which provides no security by way of mortgage or pledge, but which may or may not contain covenants affording protection to debenture holders by way of equitable mortgage or covenant for future mortgage, or covenants conferring other privileges upon the holders.

It would be impossible, within reasonable compass, to describe in detail the almost innumerable variations in the provisions of different issues of corporate obligations and of instruments securing or safeguarding the same. The scope of this paper necessarily must be confined to an outline of the essential and customary forms of such instruments. Preliminarily to undertaking actually to prepare the mortgage, the draftsman should obtain complete information not only (1) as to the pertinent provisions of the constitution or the statutes of the States having jurisdiction over the corporation or the corporate property, and corporate compliance with such provisions, but also as to (2) the conditions under which the debt is to be contracted and its possible amount as affected by statutory restrictions; (3) the form of the obligation to be issued to evidence the debt and the privileges to be given to the holders of such obligations; and (4) the general character of the security to be provided, or the benefits to be afforded by the indenture providing for and governing the issue of the obligations.

(1) *As to corporate authority.* Except as restricted by constitution or statute or by provision of the charter or by-laws, as before stated, a corporation has implied power for its proper corporate purposes, to contract debts and to issue written obligations evidencing such debts. This is true of railroads and public utilities corporations as well as of private business companies. If there be no incident mortgage or pledge of property, inquiry may be limited to ascertaining whether the ordinary borrowing power of the corporation is subject to any express limitation or regulation either in the constitution or

laws of the State of incorporation, or possibly, of any State in which corporate property has a situs, or in the charter or the by-laws of the corporation. Care must be taken to meet all such requirements. At this point, it is not necessary to consider what may be the rights of *bona fide* holders of securities issued *ultra vires*. It is the duty of counsel to avoid any such questions by examination into and compliance with specific legal requirements.

If, however, the borrowing corporation purposes to give security for its debts, as before stated, a sharp distinction must be drawn between corporations operating under public franchises and those conducting private businesses. In this country, as well as in England, the general rule is that when the government grants a franchise to a particular person, it is presumed to trust that person, and no other, and the powers conferred are not transferable unless expressly authorized by law.

A private business corporation, however, as before stated, has the same implied power to mortgage and pledge its property to secure its debts, as it has in respect of the contracting of the debts. The restrictions are such only as may be imposed by constitution or statute or by express provision of the charter or by-laws.

(2) *The character of the debt and the conditions under which it is contracted.* Where the debt in its entirety has been or is contracted antecedently to or contemporaneously with the execution of the indenture, of course no question is presented as to the conditions upon which the debt may be incurred. But if, as generally is the case in corporate borrowings, a considerable part or all of the debt is to be contracted subsequently to the execution of the mortgage or indenture, the conditions under which it is to be incurred must be presented with definiteness. The amount of the debt to be secured is the essence of the mortgage or pledge. It affects directly the rights of every bondholder, and the courts will hold the mortgagor and the trustee to strict compliance with the terms of the instrument authoriz-

16 PREPARATION OF CORPORATE BONDS, MORTGAGES

ing the creation of the debt. The method of expressing such terms in the indenture will be considered later.

Wherever, as in many States, the amount of corporate indebtedness is limited either by reference to the amount of the capital stock or otherwise, any possible excess of debt must be carefully guarded against.

(3) *The form of the obligation to evidence the debt and the privileges to be given to holders.* Under this head, special forms of corporate securities such as equipment-trust obligations, demand obligations, etc., are not considered. We are now considering only corporate obligations to pay at stated times, issued in series for circulation in the markets, and constituting charges upon the general credit of the corporation. If sufficient for identification, even by parol, the simplest statement of indebtedness will entitle the obligations to the benefit of the security so far as concerns merely the payment of the debt. The elaborations of the obligation are intended as inducements to purchasers.

Primarily, a corporate bond contains a promise to pay a fixed sum at a time and place specified, and to pay interest thereon at a rate, time and place also specified. To identify the bonds as entitled to the benefits of the indenture, the bonds set forth the amount and title of the issue, and the parties and date of the indenture, and refer to the indenture for a statement of the security (if any) and the rights of the trustee and of the bondholders in respect of such security or under such indenture.¹

There is a recital also that certification by the trustee under the indenture is requisite to the enforceability of the bond.

¹ A mere recital that the bonds are issued under an indenture, according to a Minnesota decision (*Guilford v. Minneapolis &c. Ry.*, 48 Minn. 560; 1892. 51 N. W. 658; 1892. Elliott on Railroads, Vol. 1, pp. 653-654; 1907; Sec. 484) does not limit the rights of the holder of the bond. (See also 49 L. R. A., N. S. 155-159 and Mr. Foster's exhaustive brief in *Watson v. C. R. I. & P. R. R.*, 169 App. Div. N. Y. 663; 1915). But, if the indenture contain provisions rendering uncertain the date of maturity of the bond, and these are brought into the bond by its reference to the indenture, the bond may have been deprived of negotiability (*McClelland v. Norfolk & Southern R. R.*, 110 N. Y. 469; 1888). No such effect would result if the contingency be merely to make the bond

COLLATERAL TRUSTS AND DEBENTURE INDENTURES 17

This certification then becomes as essential to the validity of the bonds as to the security thereof by the indenture.¹

Such a simple bond properly executed and attested is the stock upon which from time to time have been grafted various provisions intended to make the bonds attractive to purchasers or to protect the obligor. The number and variety of such provisions are many, limited only by the ingenuity of the borrower and the necessity of avoiding any contravention of the promise to pay. Some of the more usual provisions may be noted.

(a) The first important provision concerns the form of obligation whether as coupon bonds payable to bearer (with or without a provision for the registration of the principal in the name of the owner), or as registered bonds without coupons, payable both principal and interest to the registered holder or assigns. If the bonds are issuable in each form, the market now expects that the coupon bonds and registered bonds shall be interchangeable. In such case the bonds must state briefly the conditions upon which the registration or the interchange may be made. The coupons attached to coupon bonds invariably are payable to the bearer regardless of the registration of the principal.

(b) The bonds may be issuable in various denominations and the several denominations may or may not be interchangeable. If the denominations are interchangeable, the conditions of interchange should be set forth.

(c) It is advisable always to include in the bond a waiver of

become due earlier than a date fixed for maturity (*Chicago Railway Equipment Co. v. Merchants National Bank*, 136 U. S. 268; 1889. *Negotiable Instruments Law*, New York Consolidated Laws, Chap. 43, Sec. 23-2). The present policy of the Stock Exchange disfavors the restricting clause considered in the *Rock Island* case (169 App. Div. 663; 1915) and it would be better now to adopt the form quoted by Mr. Foster: "The principal sum of this bond may be declared due before the date above stated in the manner and with the effect provided in said trust deed." Consideration will be given later to the provisions of the trust deed in this particular.

¹ *Maas v. Mo. Kan. & Texas Ry.*, 83 N. Y. 223; 1880.

18 PREPARATION OF CORPORATE BONDS, MORTGAGES

liability of officers, directors and stockholders, even if at the time of the issue of the bond no such liability exists. Subsequent use or acceptance of statutory provisions of consolidation or amendment of charter or otherwise, may constitute an acceptance of all statutory burdens existing at the later date and may involve a personal liability not existing at the date or at the issuance of the bond. Indeed, comparatively recently the Supreme Court of the United States has held that a corporation formed in a State without stockholders' liability, but declared to be intended for business in a State with such liability, may by carrying on such business bring its members under the liability laws of the latter State. The better practice is to insert the waiver in the bond as well as in the indenture.

(d) It is the general practice to make the payment of the obligation subject to acceleration in case of default in one or more of the covenants in the bond or in the indenture. It is well that such a statement should appear also in the bonds. Otherwise, in such case, the default will not entitle the trustee to foreclose for the principal debt.¹

(e) If the obligor desires to reserve the right of redemption of some or all of the bonds before maturity, the condition upon which such right may be exercised should be briefly stated. In this connection, the Stock Exchange Committee requires a clear statement of the method, the notice and the period for which notice shall be given.

(f) If a sinking fund is to be set up, there may well be a brief statement referring to the mortgage provisions therefor.

(g) Any right to convert the bond into stock should be also the subject of reference to mortgage provisions sufficient to cover contingencies of consolidation,² of increases of stock, or the creation of preferred stock.

¹ Cf. *Mallory v. W. S. R. R.*, 35 Superior Ct. (N. Y.) 174; 1874. See also, *Batchelder v. C. G. W. Co.*, 131 N. Y. 42; 1892. *Watson v. C. R. I. & P. R. R. Co.*, 169 App. Div. 663; 1915. And *Jones' Corp. Securities*, Sec. 56; Ed. 3, 1907.

² *Rosenkrans v. Lafayette &c. Ry.*, 18 Fed. 513; 1883. *Parkinson v. West End Ry.*, 173 Mass. 446; 1899; 53 N. E. 891; 1899.

COLLATERAL TRUSTS AND DEBENTURE INDENTURES 19

These last three points will be considered more fully in connection with the subject of Collateral Trust Indentures.

Prior to the outbreak of the present European war, attended by wide and perilous fluctuations in exchange discouraging such practice, it was quite customary in large bond issues to provide for the issue of bonds payable at the option of the holder at home in United States gold coin, or abroad, and in the latter event, in foreign currencies, sometimes, in one or more such currencies, or at one or more places. Such an obligation must define, or render possible of certain definition, the amount payable in each designated place, or it will not be negotiable.¹

Until the enactment of the Federal Income Tax Law, it was almost invariably the practice for the obligor to covenant to pay principal and interest without deduction for taxes. While this covenant still is demanded generally by investors, many large corporations, realizing the uncertainty of the obligation, are adopting the policy of omitting any such provision from recent bond issues. It is asserted, and it also is denied, that the present Federal Income Tax Law makes void any subsequent promise of an obligor to pay the normal federal income tax of the holder of the bond in respect thereof. In absence of a controlling adjudication it is better not to insert such a promise.²

The ordinary coupon is a promise to pay a specific sum at a certain time and place, stated to be interest for a named period upon a bond bearing an indicated number. If the bond be subject to redemption before the due date of the coupon, the coupon should recite that its payment is subject to the call of the bond for previous redemption. In view of the many judicial opinions that for most purposes a detached coupon constitutes a separate and distinct obligation of the

¹ *Parsons v. Jackson*, 99 U. S. 434; 1878.

² *Haight v. Pittsburgh &c. R. R.*, 6 Wall. (U. S.) 15; 1868. The provision referred to is omitted from the new Income Tax Act of 1916.

20 PREPARATION OF CORPORATE BONDS, MORTGAGES

corporation,¹ it is desirable that the coupon itself should distinctly state every intended qualification of the direct promise to pay.

The trustee's certificate, usually endorsed on bonds, is merely a statement that the bond is one of the bonds mentioned in the indenture, and is signed by the trustee.

(4) The general character of the security or the benefits to be provided for the bonds.

The security may be a mortgage of real estate or of chattels, or a pledge or assignment of bonds, stock or other securities, and may or may not be subject to prior liens. Most large mortgages include some of each of the several classes of property.

The security may be for the protection of two or more series of bonds, the several series not ranking equally but having relative priorities. The Stock Exchange Committee considers it undesirable to have different series of bonds of unequal rank secured by mortgage to the same trustee; but oftentimes such a unity is the necessary result of preëxisting obligations. An illustration of prior lien series and subordinate lien series of bonds secured by the same instrument, is the First Consolidated Mortgage of 1895 of the Erie Railroad Company and the recent Consolidation Mortgage of 1913 of the New York Central, the latter securing several classes of previously issued bonds entitled to different relative liens on the mortgaged property. It is not easy to draw an instrument to express with artistic completeness the relative rights of different lien holders in relation to the many provisions of the instrument. Of course, if the subordinate lien is created by a different instrument, it is comparatively simple to recognize prior liens by an appropriate reference in the grant.

If there be no security, some of the provisions appearing in indentures affording benefit to bondholders, are covenants to

¹ *Watson v. C. R. I. & P. R. R.*, 169 N. Y. App. Div. 663; 1915. *Continental Securities Co. v. N. Y. Central R. R.*, 217 N. Y. 119; 1916.

make no future mortgage, or to secure the bonds under and by a future mortgage, if any be given, or to maintain a specified amount of quick assets, or to provide a sinking fund to redeem the bonds.

Some of the matters to be considered in stating these rights will be referred to in discussing the form of collateral trusts or debentures.

The Modern Corporate Mortgage

The corporate mortgage of the present day, as a result of the great advance in the activities and needs of corporations, particularly railroad corporations, has taken on form, features and dimensions vastly different from the early indentures which we have been considering, and includes an elaborate contract as well as provisions for an expanding lien.

The following illustrations may be given of a few of the complexities of the contract for which provision must be made in the mortgage indenture and of the reasons therefor:

(a) The investment market requires a form of obligation which may be made non-negotiable, partly or wholly, temporarily or permanently, in order to protect trustee holdings, or to guard against loss by theft. Thus are required (as a substitute for the early day safety precaution of detaching all coupons) detailed provisions for the registration of the principal sum of the bonds (leaving the interest to continue to be payable to the bearer of the coupons) or else for the registration of the bond as to both principal and interest (in which case the mortgage should recite the form of such fully registered bond), and finally for the interchange of coupon bonds and fully registered bonds. Until a comparatively recent date, such interchange was not provided for, and the consequence was that at times the market quotation of coupon bonds and registered bonds without coupons of the same issue varied by more than one per cent. The most succinct statement in the indenture of such rights of registration and interchange would cover as

22 PREPARATION OF CORPORATE BONDS, MORTGAGES

many folios as were contained in the old Erie mortgage of 1849.

(b) The modern mortgage generally must be something more than a security for a debt then or theretofore created. In most cases it embodies an agreement to provide for future advances. If the mortgage debt is subject to increase, then of necessity there must be expressed precisely the conditions of increase. The investing public, through the bond distributing houses and the large investing institutions such as the insurance companies, require a greater and greater specification of the safeguards in connection with any permission to augment the mortgage debt. If the increase is to be allowed for additions and improvements, the mortgagor must be required to furnish elaborate statements as to the construction or the acquisition to be paid for out of the additions to the debt. If only the refunding of prior obligations is the purpose of increase, then again there is necessary a recital of the conditions governing increase for that purpose and a prescription of the method in which the refunding is to be accomplished. Occasionally the refunding is of bonds of subsidiary corporations, which, of course, will involve still further details of procedure. There are many recent corporate mortgages in which the provisions concerning additional bond issues cover ten times the number of printed pages required for the old Erie mortgage.

(c) In view of the ready currency of corporate obligations in the investment market and of the large amount of the aggregate debt, the individual trustee has given place to a corporate trustee to accept the mortgage conveyance, and by its certificate to authenticate the bonds as being issued in accordance with the terms of the mortgage indenture, thus interposing protection against irregular or unauthorized issues. This development has been accompanied by a further specification of the duties of the trustee. Corporate mortgages of realty continue to confer upon the trustee a power to enter and to operate the mortgaged premises, but the present effect of this provision is little else

than to afford a basis for the appointment of a court receiver and for the assertion of a claim upon the income. Existing State laws limiting the powers of foreign corporations may effectually nullify a granted power to a corporate trustee to enter and operate, even though the trustee were willing to assume the liabilities incident to the conduct of a complex business. Consequently, there has grown up the custom of a more comprehensive specification of the remedies available to a trustee in case of default. Oftentimes the mortgaged properties extend through several different States, with varying and often conflicting laws, and it is the prevailing opinion that in the interest of expeditious and uniform procedure, there shall be a definite statement of the rights of the trustee and the bondholders, as full as practicable in view of the diversity of laws. Among the important rights thus specified are generally, the right to declare the entire principal due in case of default in the payment of any interest or of default in one or more other conditions, with a reserved right of waiver (which is quite necessary), the right to foreclose by suit or otherwise as may be advised by counsel, the right to sell without such foreclosure (limited in practice generally to sale of pledged stocks and bonds), the right to recover a deficiency judgment for the benefit of bondholders, the right to apply for a receiver, the right of the bondholders to precipitate the maturity of the principal upon a foreclosure sale for default in interest, the right of the bondholders to use the bonds and coupons in payment of the purchase price of the mortgaged property upon a foreclosure sale, the limitation upon the right of the bondholder to sue under the indenture unless the trustee shall fail in its duty, and the waiver by the mortgagor of any right to claim the benefit of any stay or extension or appraisement laws.

(d) The corporate mortgage of to-day includes a varying number of covenants, designed principally to compel the company to maintain the priority and integrity of the mortgage security. In the old Erie mortgage above mentioned, the only

24 PREPARATION OF CORPORATE BONDS, MORTGAGES

covenant is one to execute further assurances. The number and the scope of the covenants now inserted in such instruments vary according to the character of the corporation and the nature of the security. Generally speaking, more comprehensive covenants are required from a strictly private corporation than from a quasi-public or public utility corporation, whose corporate transactions promptly become publicly known. It would seem that the larger and more prominent the corporation, the less is the number of covenants deemed necessary by bond buyers. Oftentimes, the security is of a nature that suggests and requires covenants of special application. To illustrate, in the Interborough Rapid Transit mortgage of 1912, which operates, or in the future will operate, under many different contracts, leases and certificates, there are numerous covenants strictly limited in application, but deemed necessary to prevent impairment of the mortgage security by defaults by the Company under its leasehold and other estates. So in a case where part or all of the security under an indenture consists of shares of stock or bonds of other corporations, the mortgagor must be and always is shorn of power to alter the capitalization of such corporations to the detriment of the security under the indenture.

(e) The events of default upon which the trustee may assert the remedies provided by the mortgage are specified in correspondence with the respective covenants. It is not practicable to include within a single omnibus default clause the right of the mortgagee to exercise the remedy upon default in any of the covenants. The period of grace intervening between a default and the enforcement of the remedy therefor, upon a reasonable view of its application, may properly vary according to the nature of the default, as for instance, a longer period of grace is allowed after default in payment of taxes than after a default in interest. Less important covenants may be the subject of actionable default only after notice and demand of performance shall have been made on the company. In other cases, the period of grace should begin to run without re-

quirement of precedent notice, notably in case of failure to pay interest, a default as to which the mortgagor has the earlier knowledge. Oftentimes, as in the case of the Interborough Rapid Transit mortgage, the events of default are numerous.

(f) The reservation to the mortgagor of the right to obtain releases from the trustee upon stated conditions, is another highly important feature of the modern mortgage. The necessities of a trunk-line railroad, for instance, to obtain for various purposes releases of portions of its mortgaged properties are often imperative, particularly in connection with dealings with governmental authorities. Provisions for releases of mortgaged property require careful drafting in order to protect the bondholder and the trustee, and at the same time afford to the company reasonable freedom of action. Precedents may be found in the New York Central mortgage of 1913 and the Northern Pacific mortgage of 1914.

It is such complexities of contract that enlarge some of the present-day corporate mortgages to volumes of two hundred printed pages. It has been remarked that it was devoutly to be wished that some genius would arise to point the way to a reduction of the text of such instruments; but where the opportunity has been afforded to discuss the subject with such critics, they have been able to indicate little which upon full consideration they would be willing to omit. Some fifteen years ago the eminent general counsel of a railroad in the Central States submitted a form of refunding mortgage which was unsatisfactory to the bond-purchasing bankers as being in what was considered a primitive style, and on behalf of the bankers there was submitted a form of mortgage in the form which had become familiar in New York. The first criticism of the railroad counsel was the general one that to a large extent he regarded most of the provisions of the mortgage ineffectual. On subsequent and careful analysis the only provision which finally he was prepared to condemn as useless was a provision in general terms that as a matter of right the trustee should be

26 PREPARATION OF CORPORATE BONDS, MORTGAGES

entitled to the appointment of a receiver, a statement which he considered assumed to limit the discretionary power of the court, but which had proved useful in aiding the court to exercise its discretion. One New York counsel was quite outspoken in his criticism of the length of corporate mortgages until charged with the duty of preparing one for an important street railroad system. Upon careful consideration of this it was found to be in some respects more elaborate in detail than some for which I may have been regarded as responsible.

It is very well to argue that various provisions expressly set forth in a corporate mortgage would be implied in any event in any controversy before a court; but it may be said that those who have had large experience in such matters are convinced that the answer to the question whether rights or obligations will be implied by a court, oftentimes is affected by the atmosphere surrounding the litigation. Substantially all of the provisions from time to time added to corporate mortgages have been intended to avoid contentions which previously had been made in reported cases. Furthermore, it is to be remembered that a substantial part of the modern mortgage concerns the duties and responsibilities and immunities of the corporate trustee. In practical experience, a trust company, having many corporate mortgage trusts, is called upon daily to perform, or to refrain from performing, acts which may or may not be specifically provided for in the indenture. If they are specifically provided for, the action or non-action follows as a matter of course. If not clearly authorized, the question is referred to counsel for advice, with incident delay and expense. Perhaps the greatest amount of study and care in the drafting of corporate mortgages has been to regulate specifically the relative rights of the mortgagor and the trustee prior to any default whatsoever. Under the old mortgages prior to default the trustee was regarded generally as little more than a "rubber stamp."¹ In the new mortgages, the trustee's activities before

¹ *Rhineland v. Farmers Loan & Trust Co.*, 172 N. Y. 519; 1902.

default certainly are more varied and oftentimes involve questions more difficult than are raised upon a foreclosure, and the provisions for the protection of the trustee deserve the most careful consideration and adequate statement.

From this extended introduction, we may proceed now, and, for the sake of emphasis, at the risk of some repetition, to indicate in detail the general method of preparing the indenture intended to regulate the issue of the bonds, to express the rights and remedies, severally and respectively, of the parties to the indenture and the bondholders and to provide security for the bonds. The purpose will be to suggest provisions, and the purpose of provisions, which have been adopted as the result of experience. These may be considered conveniently under the following heads :

- I. Names of the parties and the preambles.
- II. The consideration and grant or the assignment in trust.
- III. The conditions governing the issue of the bonds, including (1) limitations in amount, and (2) conditions of (a) certification and delivery, (b) registration, and (c) interchange of the bonds.
- IV. Particular covenants of the mortgagor.
- V. Provisions as to any pledged stocks and bonds.
- VI. Remedies of trustees and bondholders.
- VII. Releases and leases.
- VIII. Consolidations, mergers and purchases affecting the mortgagor.
- IX. Provisions concerning the trustee.
- X. Possession prior to default, and defeasance.
- XI. Acceptance of the trust by the trustee.
- XII. Execution, acknowledgment, recording, affidavits of good faith, etc.
- XIII. Miscellaneous provisions.

I. Names of the Parties and the Preambles

Of course, the party of the first part is the mortgagor. Either following its corporate name or in the preambles should be mentioned the State of incorporation, and whether the company was organized under general laws or created by special charter,

28 PREPARATION OF CORPORATE BONDS, MORTGAGES

or consolidation, or merger or otherwise. The party of the second part is the trustee to accept and to hold the title in trust for the takers of the bonds. Any person, not incompetent or an infant, even a bondholder, may be trustee, but, under the rules of the Stock Exchange, not a director or officer of the mortgagor company. It is desirable, however, to have a corporate trustee to control the issue of the bonds, and to hold possession of pledged securities or moneys. In view, however, of the varying laws of the several States limiting the rights therein of foreign corporations, in many jurisdictions it is safe to join with the corporate trustee an individual to act as co-trustee. In this particular the laws of the several States are various and many are of uncertain scope. A statute of California assumes to require the association of a California trust company with every foreign trustee. Even the law of New York contains provisions¹ which may limit the rights of a foreign trust company to act as a mortgage trustee of property within this State. If there be more than one trustee, the relative rights of each should be set forth, as will be more fully mentioned in the discussion of the provisions concerning the trustee.

The functions of the preambles following the naming of the parties, are first to explain the purposes of the indenture, and next to constitute representations by the maker which after the issue of the bonds will serve as an estoppel against it and those claiming under it. It is advisable to state in the preambles that the mortgage and the bond issue have been duly authorized by due corporate proceedings, but it is best not always to quote literally the resolutions of the directors or stockholders, unless it is absolutely certain that as quoted the resolutions are legally sufficient. Such a quotation of resolutions not legally sufficient may be ineffective as an estoppel, whereas a simple statement of due authorization would be entirely effective. The fact of stockholders' due consent to the mortgage

¹ N. Y. Banking Law, Secs. 233, 185, — Consolidated Laws, Chap. 10.

should similarly be recited in those cases where it is required by statute, charter or by-laws. This is desirable especially in the State of New York to obtain the protection afforded by Sec. 7 of the Stock Corporation Law¹ against the perils of a lack of sufficient consent by stockholders.² It may be well also to insert immediately before the grant, a clause stating expressly that all acts and things required by law and otherwise in respect of the mortgage and the bonds have been duly performed and complied with: thus clearly creating an estoppel operative generally in favor of those purchasing bonds upon faith of such statement.³ Of course, as to acts that in the strict sense are ultra vires the corporation, there can be no estoppel, but there may be as to acts irregularly or even insufficiently performed if they are within the general scope of the powers conferred by the legislature.⁴ Such deficiencies do not affect the apparent rights of bona fide purchasers for value, and the presence of such an express assertion of regularity may assist the purchaser in repelling an attack upon his good faith.⁵

To identify the debt secured, the form of the bonds, the coupons and the trustee's certificate usually are set forth. If variation be permitted in any of the bonds of the issue, it is prudent to make a brief statement of the authorized variations. It is the general opinion that the description of the bonds or debt secured should be precise; and if practicable it is well that this should be the case, but I believe in the sufficiency of any description of the debt beyond reasonable possibility of mistake. In this view, mere subdivisions of amounts or slight variations of terms would not affect the security of bonds otherwise practically identifiable.

¹ N. Y. Consolidated Laws, Chap. 61.

² *Vail v. Hamilton*, 85 N. Y. 453; 1881; *The Vigilancia*, 73 Fed. Rep. 452-457; 1896. *Hamilton Trust Co. v. Clames*, 17 N. Y. App. Div. 152; 1897.

³ *City Ry. Co. v. Citizens' St. R. R. Co.*, 106 U. S. 557-566; 1896.

⁴ *Louisville N. A. & C. Ry. Co. v. Louisville Trust Co.*, 174 U. S. 552-574; 1898.

⁵ See *Logan County Bank v. Townsend*, 139 U. S. 67-72-76; 1890; and cases cited.

30 PREPARATION OF CORPORATE BONDS, MORTGAGES

II. *The Consideration and the Grant or the Assignment in Trust*

After the preambles follow the granting clauses, prefaced by a statement of the consideration. Formerly this was stated as being a nominal sum paid by the trustee, but now it is recognized that besides the trustee's reception of the property for the specified purposes a real and important consideration exists as to the cestui que trusts, that is, the purchasers of the bonds, and as to them the principal consideration is their purchase and acceptance of the bonds.

As to the granting clause, it may be said first that if the mortgage be of real property the description should be sufficient to enable the mortgage to be made a record lien. In the case of large corporations it is seldom practicable to give any detailed description of the property. It is advisable to make the grant comprehensive by conveying *all* the property of the company in specified jurisdictions, and if desired, to follow the general grant by stating that the same *includes* property thereafter more fully described. It is generally convenient by a clause of exception to reserve any property desired to be retained *free* of the mortgage rather than to describe all the property that *is* included. If a land grant is to be included this should be done expressly and adequately, for land does not pass as appurtenant to other land.¹

The laws of the jurisdictions concerned should be examined carefully as to the protection of any mortgage lien upon chattels. Generally it is impracticable to give a satisfactory lien on movables, if the same are liable to pass out of the jurisdiction in which the mortgage is recorded or filed as a chattel mortgage. The question is important where the mortgage assumes to cover private rolling stock or other vehicles. As to railroads, the statutes of many States declare the appurtenant chattels of a railroad to be real estate for mortgage purposes.

Turning for a moment to mining, lumbering and trading

¹ *N. O. Pac. Ry. v. Parker*, 143 U. S. 42-55; 1891.

companies, it may be observed here that serious questions are presented by the statutes in force in nearly all the States making void any instrument which purports to mortgage stock in trade left in the custody of the mortgagor, such transactions being deemed, as stated in the early cases, "a badge of fraud."

The statutes and the decisions upon this point in the several States in which the property may be located should be examined, and, when the question is doubtful, stock in trade should be excepted from the mortgage by clauses as exclusive as language permits. The question is of particular importance in respect of mortgages of mining and lumbering companies where part of the realty through removal or severance becomes the stock in trade of the owner.

If any leaseholds are to be covered by the mortgage, the consent of the lessor should be obtained if the lease contains a covenant against assignments. While the making of a mortgage leaving possession in the mortgagor does not constitute a violation of such a covenant, the enforcement of the mortgage by entry or foreclosure in some jurisdictions would constitute a violation.¹ It is doubtful whether the reservation from the mortgage of the last day of the term of the lease is effective to avoid a violation of such a covenant.

If the security includes corporate bonds, stocks and other securities, the lien should be effected, if practicable, by deposit of the same with the trustee in order to create a legal pledge. If not so delivered, the same should be expressly assigned and notice of the assignment should be given to the persons holding the property.

After the conveyance of the property owned by the corporation, it is important to determine if any future-acquired property is to be included in the mortgage. It is well settled that, being expressed in apt language, a mortgage of after-acquired property

¹ *West Shore R. Co. v. Wenner*, 70 N. J. Law, 233; 1904. *Contra, Riggs v. Purcell*, 66 N. Y. 193; 1876. *Dunlop v. Mulry*, 85 A. D. (N. Y.) 498; 1903.

32 PREPARATION OF CORPORATE BONDS, MORTGAGES

is practically effective as a lien.¹ In most cases the value of the corporate property to a large extent depends upon its use as a going concern, and generally, and in fact almost invariably, it is required by bond buyers that the mortgage shall cover at least all after-acquired property used in connection with or for the purposes of the business, however acquired by the mortgagor. It is argued by Mr. Machen² that the after-acquired property grant should cover income, not *qua* income, but as after-acquired property. This, however, has not been finally adjudicated, and if so desired it should be so stated. In that case the trustee might be entitled to the income accumulated prior to his demand for possession, or receivership.

It is logical and desirable also to include in the mortgage all after-acquired property, even if not used in connection with the described premises, if such acquisition be made out of moneys representing proceeds of bonds or of released property; but it is in order to reserve expressly from the mortgage full right on the part of the mortgagor to own or to acquire, free from the lien, any property not acquired for use in connection with the mortgaged premises or with moneys derived from the bonds or under the mortgage.

If the corporation possesses and exercises any franchise — as is the case with all public service corporations — such franchise should be included in the mortgage, for otherwise the property would have little value to a purchaser on foreclosure.³

¹ *Pennock v. Coe*, 23 How. (U. S.), 117; 1859.

An interesting question not yet finally determined arises in connection with the consolidation of two railroads each subject to an after-acquired property mortgage. (*N. Y. Security v. L. N. E. & St. L. Consol. Ry.*, 102 Fed. 382; 1900; and cases cited.) It has been held by the United States Circuit Court in an able opinion by Judge Woods that such a lien will not attach to the equipment acquired after the consolidation by the new company. This point should be covered both as to equipment and as to other accessions after consolidation, either one way or the other. See also *Compton v. Jesup*, 68 Fed. 263; 1895. *Polhemus v. Fitchburg R. R.*, 123 N. Y. 502; 1890.

² Machen, *Modern Law Corporations*, Sec. 1879 (1908).

³ See *Lord v. Yonkers Fuel Gas Co.*, 99 N. Y. 547; 1885. 101 N. Y. 614; 1886.

The franchise rights mortgaged, of course, may not include the franchise to be a corporation, which franchise is not ordinarily the subject of sale or mortgage.¹ There should be included also the income and profits of the corporation, thus creating a lien thereon which will become effective after entry by the trustee or by a mortgage receiver,² or upon the institution of a suit for possession as distinguished from a suit for foreclosure and sale.³

The habendum clause should run to the trustee, its successors and assigns forever, subject to any liens or encumbrances of recognized priority (all of which so far as practicable should be specified so as to preclude avoidable disappointments and controversies),⁴ in trust for the equal and proportionate benefit of the holders of the bonds whenever the same be issued.

III. *The Conditions Governing the Issue of the Bonds*

A most important point here to be covered, of course, is the amount of the issue which is authorized to be secured by the mortgage. Usually the amount is limited by definite statement of amount, but it may be unlimited (securing all future advances represented by the issue of the bonds), or it may be limited only by the prescription of a ratio to the capital stock from time to time outstanding, or even by some stated relation to the earnings applicable to the payment of interest.

The mortgage of the Chicago City Railway Company prepared in 1907 is an unlimited mortgage, but the use of the bonds and of their proceeds is carefully restricted to capital purposes under the direction of public authorities. The mortgage of the New York Central of 1913, and of the Northern Pacific of 1914, are mortgages unlimited by specification of amount, but subject to the requirement of a fixed relation to the capital

¹ *Memphis & Little Rock R. R. Co. v. Commissioners*, 112 U. S. 609; 1884.

² See *Allen v. Dallas & Wichita R. R.*, 3 Woods 316; 1878. *Atlantic Trust Co. v. Dana*, 128 Fed. Rep. 209; 1903.

³ *Dow v. Memphis R. R. Co.*, 124 U. S. 652; 1887.

⁴ *Central Trust Co. v. C. H. V. & T. Ry.*, 87 Fed. 815; 1898.

34 PREPARATION OF CORPORATE BONDS, MORTGAGES

stock from time to time outstanding. The unlimited mortgage is the outgrowth of the realization of the fact that it is almost impossible to forecast the possible growth and demands of a railroad system. The general mortgages made at the time of the reorganizations of twenty years ago, then considered ample, have proved inadequate in amount and in flexibility.

Specification also should be made in the indenture as to any variations in the recited form of the bonds which may be permitted under the indenture—that is, as to denominations, rates of interest of various series, conversion privileges, redemption rights, etc., and also by whom the bonds may be executed.

The amount and character of the bonds being specified, the provisions next in order and which require more careful consideration than any other, are those for the issue of the bonds. Questions continually arise between mortgagor corporations and trustees as to their relative rights and duties in respect of such issue. It is the aim of counsel of trustees, and should be the desire of counsel of mortgagors, to specify clearly all conditions upon which bonds may be issued. The trust companies desire to expedite the business of their customers, but the liabilities they may incur by unauthorized acts increasing the mortgage debt are so enormous in the aggregate that in many cases prudent trust officers are compelled to take deliberate advice of counsel with resultant expense which might have been avoided had the indenture been more definite.

The determination of the conditions upon which bonds may be issued depends solely upon practical considerations—that is to say, the marketability of the bonds. Of course, it is impracticable to indicate even generally the variety possible in respect of such restrictions. The most that can be presented is an outline of conditions which at the present time are desirable in respect of bond issues intended for general circulation.

In most cases, the mortgage provides for the issue forthwith of a specified amount of bonds upon merely the order of

the company, sometimes to be accounted for by the company before any further issue. The remainder of the bonds are reserved for future use for specified purposes. Comprehensively speaking, these purposes are to provide for the refunding or payment of prior liens and for the acquisition of additional property. The orderly practice is to reserve by separate sections the amount required for refunding and the amount issuable for additions, in each case specifying the restrictions and the conditions applicable to such issue. In such specification, detail and precision are necessary, and any matters of fact should be established by certificates and affidavits made by officers of the company or other persons having knowledge in the premises, and filed with the trustee. The mortgage should provide expressly that all such writings shall be conclusive in establishing the matters therein stated in favor of the trustee as against the bondholders and all others. Without incurring expense which the mortgagor would be quite unwilling to pay, it would be impossible for a trustee to make separate investigation of the many requisite matters of fact. If any questions of law are to be determined, the mortgage should provide for the furnishing of the written opinion of counsel, also to be filed with the trustee. In the case of large corporations having legal counsel of recognized capacity, it is usual to specify that such opinion may be that of the counsel for the company; but if this be desired, express authority should be conferred on the trustee to receive such opinion. Some of the legal questions to be determined in connection with bond issues are the necessity of authorizations by governmental commissions, the sufficiency of conveyances of any property, and the effective attaching of the lien of the mortgage upon new property.

As to the bonds to be issued for refunding, the general practice is to provide that the refunded bonds be delivered to the trustee, and, if so desired, that the same shall be kept alive so far as legally practicable, and also that the new bonds be issued in exchange for such deposited bonds. To avoid any question

36 PREPARATION OF CORPORATE BONDS, MORTGAGES

in the premises, the authority to the trustee to receive such refunded bonds should in terms provide that the same may be before, at or after maturity, and may be either canceled or uncanceled. It is usual, also, to provide that within a limited period prior to the maturity of an underlying bond issue, the mortgagor may receive refunding bonds for the purpose of sale, provided the face (or other) value be deposited with the trustee, to be withdrawn from time to time upon the deposit of the refunded bonds. If canceled bonds are to be received, there should be a requirement that evidence be presented that no bond in lieu thereof has been issued and is outstanding.

As to the issue of the bonds reserved for additions, there has been a considerable variation during the past twenty years in the attitude of the investment market. In the reorganization mortgages of twenty years ago, the usual provision was for the issue of a comparatively small amount of the bonds in each calendar year, the object being to prevent sudden increase of fixed charges. The additional bonds were not issuable until the bonds previously issued had been applied to improvements as established by certificates of officers of the mortgagor. The rapid growth of the railroads made these provisions inadequate, and during a few years prior to 1907, mortgages often provided for the issue of a substantial amount of bonds to be reserved in the hands of the company itself for use for improvements, and permitted additional bonds to be issued at any time as fast as previous issues had been used up.

Following 1907, however, the requirements of the bond-buying houses and institutions became more exacting, and the usual provision now is that no bonds shall be issued under the mortgage except to reimburse the company for moneys actually expended, unless the proceeds of the bonds be deposited with the trustee to be withdrawn from time to time for immediate expenditure by the company for capital purposes authorized by the mortgage. The rate at which the bonds are to be issu-

able to reimburse the company, may be either their face value or a specified percentage of their face value, and the same rule applies to the amount of money deposited with the trustee upon the issue of bonds.

In many cases, especially those of industrial corporations, the requirement is that bonds shall be issued only to the extent of 75 per cent or 80 per cent of the cost of improvements, requiring the company to make up the deficiency out of its general funds.

The expenditures by the company for which bonds or their proceeds may be used are established by certificates made by competent persons and filed with the trustee. These certificates are required to contain statements identifying the property affected and indicating that the expenditures are for the purposes chargeable strictly to capital account.

The provisions for the issue of the bonds should be in detail as to both coupon bonds and registered bonds and their interchange, and they should be such as to permit of the issue of registered bonds as such originally and without necessity of interchange. They should permit also the transfer of registered bonds.

There should be provisions also for the issue of new bonds in place of bonds mutilated or destroyed, or of registered bonds lost. Considerable danger attends the issue of new bonds for coupon bonds claimed to be lost, and usually it is better as it is safer to put a claimant for such a bond to his proof by a legal proceeding. An illustration of the attitude of the courts toward such claimants is indicated by the decision of *Switzer and Co. v. N. Y. Central Co.*¹

In view of the care and time required for the preparation of engraved definite bonds, it is a matter of practical convenience to provide in the mortgage for the issue of a temporary bond or bonds in typewritten or printed form of large denomination, to be exchangeable for the definitive bonds when prepared.

¹ 152 App. Div. (N. Y.) 70; 1912.

IV. *Particular Covenants of the Mortgagor*

The mortgage should contain a covenant to pay the principal and interest of the bonds, in substance corresponding to the similar covenant in the bonds, but subject to the provisions of the mortgage. A breach of the covenant to pay thus will constitute a breach of the covenant in each instrument: as either breach will create a right of action *in personam* either may be enforced.¹ In many of the large mortgages made within the last year or two, there is inserted in this covenant a provision for the protection of the company, against liability under the income tax law, authorizing it to require persons entitled to interest to furnish proper certificates in compliance with the terms of that law.

Another covenant proper for all mortgages is that to execute further assurances, and to obtain further assurances from others obligated to the company to make conveyance.

In mortgages covering limited parcels of real estate, there is usually inserted a covenant as to title and freedom from encumbrances except as specified.

If the place of payment of the principal and interest of the bonds is stated in general terms as being the office or agency of the company, there should be a covenant in the mortgage to maintain such an agency at the place stated.

If the bonds are subject to registration, a covenant should be included to maintain books at the office or agency in which such registration may be made under reasonable regulations and where transfer of registered bonds similarly may be made. Where a new bond is issuable upon any transfer or interchange, a nominal charge, usually one dollar, is made by the company to cover the expense, in addition to the amount of any revenue stamp chargeable against the transferer.

It is customary in all mortgages to include a covenant to maintain in good condition the mortgaged premises, and in rail-

¹ See *Hulbert v. Clark*, 57 Hun. (N. Y.) 558; 1890.

road mortgages a covenant to keep in proper repair all equipment and to replace it when worn out or otherwise disposed of, and also to keep a record of all rolling stock and to permit it to be inspected by the trustee.

Other general provisions are those to pay taxes and assessments (subject, however, to the right of the company to test the legality thereof), to maintain the priority of the mortgage lien, and to discharge claims of mechanics, laborers and others.

Besides these there are the covenants to apply proceeds of bonds only as authorized by the mortgage, and to record the indenture and to pay any recording tax, the trustee usually being discharged from any and all responsibility to cause the record to be made.

V. *Provisions as to Pledged Stocks and Bonds*

Provisions as to pledged stocks and bonds of course are appropriate only in an indenture in which the security in whole or in part consists, or may consist, of such property; but the number of large corporate mortgages which include such securities is far greater than of those which do not. The points necessary to be considered in connection with such pledges will be discussed in the paper upon Collateral Trusts.

The principal interest of the pledgor is to reserve until default the right to collect the income and to exercise the other rights of an owner of the pledged securities. This is accomplished by express provision to that effect, and by the further provision sometimes that until default no transfer shall be made upon the corporation books of the shares for which the certificates indorsed for transfer by the pledgor are delivered to the trustee, and sometimes that the trustee may transfer the same to itself or its nominee either immediately or when it deems proper. In case of such transfer of stock it is usually stipulated that from time to time when and as requested prior to default the trustee shall give to the pledgor a proper proxy to vote thereon except as expressly limited.

VI. *Remedies of Trustees and of Bondholders*

Under this head we may consider the defaults in respect of which the remedies may be invoked, particularly the three principal remedies: (1) the right to declare the principal due, (2) the right of entry either by the trustee or a receiver, and (3) the right of foreclosure and sale either with or without suit.

Among the usual defaults are (a) default in the payment of principal of any of the bonds when the same shall have become due whether at maturity, or prior thereto by declaration or otherwise, (b) default in the payment of any interest on any bond, (c) default in the observance of any other important covenants in the mortgage, such as sinking fund obligations, rentals or taxes affecting valuable parts of the mortgaged premises, and (d) default in payment of principal or interest of underlying bonds.

In case of defaults, other than a default in payment of the principal of a bond, it is usual to allow to the mortgagor a period of grace. In the case of railroads this period of grace generally is six months and in cases of other companies thirty or sixty or ninety days from the date of default, notice thereof not being required. Defaults in the due observance of other covenants of the indenture usually are penalized only after the expiration of a specified period initiated by written notice of the default to the mortgagor given by the trustee or the bondholders — the purpose of this provision being to require observance of all the covenants, without subjecting the company to irrevocable penalty for remediable defaults unless the trustee or the bondholders shall have deemed the same of sufficient consequence to give such notice.

A general remedy given to the trustee of mortgaged realty, and one which is a survival of the earliest days, is the right to enter and to operate for the benefit of the bondholders. This provision rarely, if ever, is availed of at the present time, because of the laws of the several States restrictive of the rights

COLLATERAL TRUSTS AND DEBENTURE INDENTURES 41

therein of foreign corporations, as well as because of the liabilities which the trustee might incur through such entry; but the provision should always be phrased in optional form. It affords a basis for the appointment of a mortgage receiver to collect the income and to apply the net to the amounts due on the bonds. In special cases, there has been inserted a provision that a trustee might cause to be organized a corporation to operate a property of which the trustee might deem it desirable to take possession.

Another remedy which has come down from the early real property mortgages is that authorizing the trustee itself to sell the mortgaged premises without judicial foreclosure. This ancient right is now limited in many of the States and involves so many questions of procedure that it seldom is exercised with respect to realty. It is availed of frequently at the present time, however, to effect sales of pledged securities by the trustee in the same manner as pledged securities are sold in enforcement of ordinary collateral notes by the banks.

Of course, the mortgage also will authorize the enforcement of the security by foreclosure or other legal proceedings.

As to pledged stocks and bonds, it is proper to empower the trustee in an event of default or of receivership, to terminate the right of the company to collect the income of pledged stocks and bonds, or to vote in respect of the stocks.

The mortgage should specify that it is the duty of the trustee upon request of the holders of a prescribed amount of bonds and upon receiving indemnity to enforce the provisions of the indenture in such manner as may be advised by counsel.

To prevent annoyance or damage by any litigious holder of a few bonds against the interest of the holders generally, through involving the trustee of the company in litigation in respect of the bonds or indenture, it is customary to provide that a trustee shall not be required to take any action unless requested so to do by the holders of a substantial amount of the bonds, usually 10 per cent to 25 per cent.

42 PREPARATION OF CORPORATE BONDS, MORTGAGES

Another very desirable provision gives to the trustee the right at its option to act upon an event of default without awaiting any period of grace, in case the company shall be put in the hands of a receiver at the suit of any one other than the trustee. In cases of commercial corporations, the mortgage security may be impaired if the company be left in the custody of a receiver for unsecured creditors, during the substantial period pending the termination of a period of grace. If the trustee is authorized to act promptly, it may have the receivership extended to the mortgaged property for its benefit and its protection.

In discussing the form of the bond, much attention was given to the mode of providing therein for the acceleration of the maturity of the principal of the debt in case of defaults, especially a continuing default in payment of interest. This right, of great importance to the trustee and the bondholders, should be conferred also in the mortgage with particular care. The method and the effect of foreclosing for any default except in payment of principal are vague and unsatisfactory. Unless the principal can be made to become due upon such a default, effective enforcement of the mortgage will be impracticable. Usually, this right is made exercisable by the trustee either in its discretion, or pursuant to the mandatory request of the holders of a specified amount of bonds. Without such specification the request of bondholders might have to be by all.¹ Such a right of declaration should be accompanied by the corresponding right of the holder of at least a majority of the bonds to waive the declaration and its consequences, without prejudice however to any other right of the trustee or the bondholders, or to the right of future declarations, thus avoiding the rule in *Dunpor's case*² that a condition once waived is lost forever.

It should be provided also that in case of sale of the property

¹ See *Mallory v. W. S. R. R. Co.*, 35 Superior Rep. (N. Y.) 174; 1873.

² See 4 Coke's Rep. 119 b; 1602.

for any cause either under the mortgage, or under any claim having priority thereto, the principal sum should become due forthwith without any further action.

Usually it is desirable that the entire mortgaged premises be sold in one parcel and as an entirety, and provision to that effect should be inserted in the mortgage, subject of course to other direction by bondholders or to the requirement of statutes.

The character of notice to be given of the time and place of any sale should be prescribed, and power should be given to the person conducting the sale to adjourn the same to an appointed time at the same place without further notice or publication.

The trustee should have power to execute and to deliver to the purchasers upon such sale suitable conveyances, and the mortgage should contain a power of attorney from the mortgagor to execute such conveyances, and properly also a provision that if requested by the trustee the mortgagor itself will join in the execution.

The receipt of the trustee for the purchase money should be made a sufficient discharge therefor to the purchaser, and such purchaser should not be bound to inquire as to the use or the application of the proceeds or the necessity of the sale.

Provision should be made to govern the order in which the proceeds of sale should be distributed.

It is important here to provide against acts by the mortgagor which would avoid the due payment of coupons and result in their being kept alive and entitled to the prior or equal security of the mortgage, thus increasing the debt in case of foreclosure.¹

The mortgage should provide that any such coupons so kept alive shall not be entitled to the security or to any share of the proceeds of sale except subject to the payment of the principal and of all coupons not so funded.

¹ See *Ketchum v. Duncan*, 96 U. S. 659; 1877; *Wood v. Guarantee Trust Co.*, 128 U. S. 416; 1888; *Morgan's Co. v. Texas Cent. Ry.*, 137 U. S. 171-196; 1890.

44 PREPARATION OF CORPORATE BONDS, MORTGAGES

It is usual for the mortgagor to authorize the bondholders to purchase without accountability except for the purchase price, and on account of the purchase price to use any bonds or interest obligations to the extent of the amount payable upon them out of the proceeds of sale.

A covenant usual in the modern mortgage is that the mortgagor will pay the principal and the interest of the bonds to the trustee as trustee of an express trust; and that the trustee shall have the right to recover judgment therefor either before or after or during the pendency of foreclosure proceedings. These provisions may support a claim by the trustee to recover a deficiency judgment in jurisdictions where deficiency judgments are allowable.¹

As a precaution against unforeseen contingencies, there is oftentimes inserted in mortgages a provision (of doubted legality) authorizing the mortgagor, prior to default, to surrender possession to the trustee and consenting to the appointment of a receiver. Such a provision might be useful in case of unjustifiable or predatory attempts to interfere with the exercise of the corporate powers.

In connection with the enforcement of the remedies of the trustee, the mortgage should provide specifically that the mortgagor waives its rights under any stay or extension law providing for valuation or appraisal or other postponement of the right of enforcement, and should contain an express waiver of the benefit of stay, extension, valuation and appraisal laws, and of any statutory right of redemption after a sale in enforcement of the mortgage. Even if at the time of the mortgage there be no such statutes in force, they may be made the subject of later enactment.

¹ An interesting review by Judge EARL of the right to judgment for deficiency will be found in *Frank v. Davis*, 135 N. Y. 275; 1892.

See U. S. Sup. Ct. Equity Rule 10; *Noonan v. Lee*, 2 Black 499; 1862; *Mackay v. Randolph Macon Co.*, 178 Fed. Rep. 881; 1910; *Watson v. C. R. I. & P. R. R. Co.*, 169 App. Div. (N. Y.) 663; 1915; *Grant v. Winona & S. W. Ry. Co.*, 85 Minn. 422; 1902; 89 N. W. 60; 1902.

Remedies frequently specified in important mortgages are the right of the trustee to obtain the appointment of a receiver of the mortgaged premises, the right of the company to deliver possession to the trustee prior to default, and the right of the trustee to maintain suits against impairment of the security by governmental authorities under unconstitutional legislation.

It is usual to provide that no delay or omission of the trustee shall be construed as a waiver, or a default, or an acquiescence.

The provision that all remedies shall be cumulative and not exclusive, but additional to any others given by law, has been considered already in discussing the very recent case, *Watson v. C. R. I. & P. R. R.*,¹ hereinafter examined.

The provision as to cumulative remedies probably was introduced originally to obtain or to save for the trustee a right to sue at law for the debt, concurrently with a suit to foreclose the mortgage or pledge, except where there may be statutory requirement of leave of the court,² and also to avoid any implication that conditions affecting one of the trustee's remedies, such as foreclosure by advertisement, affected his right also as to a distinct and unconditional remedy such as foreclosure by suit.³

In connection with the statement of remedies, it should be provided that no holder of any bond or coupon shall have a right to institute proceedings under the indenture for any purpose whatsoever unless first he shall have given notice to the trustee and shall have afforded to the trustee reasonable opportunity to enforce such provision of the indenture, and shall have indemnified the trustee, nor unless the holders of a specified amount of bonds shall have joined with him in demanding such action. This requirement, however, would not be operative in any case where it would bar the bondholder of his just

¹ 189 App. Div. (N. Y.) 663; 1915.

² See *Vanderbilt v. Schreyer*, 91 N. Y. 392; 1883; *Robert v. Kidansky*, 111 App. Div. (N. Y.) 475; 1906.

Morgan's Co. v. Texas Central Ry. Co., 137 U. S. 171-192; 1890.

and equitable rights as in case of unjustifiable refusal or neglect by the trustee, or where the trustee, or others acting in behalf of the trustee or of the mortgagor, hold so many of the bonds as to render it impossible for the aggrieved bondholder to obtain support in the specified amount. The trust relation of the bondholders *inter sese* would restrict inequitable oppression of the minority.¹

In the frequently mentioned recent case of *Watson v. C. R. I. & P. Ry.*,² the question was presented as to the effect of these and similar provisions, upon the right of a bondholder to obtain judgment on his bond with the view of reaching property not covered by the mortgage or pledge, which contained special provisions authorizing the trustee not only to declare the principal due, but also as trustee of an express trust to recover judgment for the entire principal of all the bonds then outstanding, together with all interest in default, and to sell thereunder the property mortgaged or pledged, and, in the event of deficiency, to enter judgment therefor. All of these steps having been taken by the trustee, the holder of one bond brought action at law in the City Court and obtained judgment which was reversed by the Appellate Term, and the reversal was sustained by the Appellate Division, where two opinions were delivered. That of the Court by Mr. Justice Clarke, seems to rest upon the fact that the trustee had acted. He says, "I am satisfied that, *the trustee having acted*, no independent action by a bondholder can be maintained." But what if the trustee had not acted? In his separate though concurring opinion, Presiding Justice Ingraham took a different and somewhat wider view, seeming to have regard to the essential equality of right in all bondholders, which equality would be violated by allowing one bondholder in his own separate right to recover a judgment enforceable against property of the mortgagor even

¹ *Linder v. Hartwell R. Co.*, 73 Fed., 320; 1896; *Cochran v. Pittsburgh Co.*, 150 Fed., 682; 1907; *Ettlinger v. Persian Rug & C. Co.*, 142 N. Y., 1891; 1894.

² 169 App. Div. N. Y. 663; 1915.

though not covered by the mortgage. This would operate to the prejudice of other bondholders relying upon, and acting by, their common representative, the trustee. Similar consideration of the equality of right and duty of co-bondholders *inter sese* was indicated in *Gue v. Canal Co.*,¹ by Chief Justice Taney who said, "It would be against the principles of equity to allow a single creditor to destroy a fund to which other creditors had a right to look for payment"; in *Pennock v. Coe*,² by Mr. Justice Nelson, who said, "To permit therefore one of the bondholders under the second mortgage to proceed at law in the collection of his debt upon execution would . . . disturb the *pro rata* distribution in case of a deficiency and give him an inequitable preference over his associates"; and in *Jackson v. Ludeling*,³ by Mr. Justice Strong, who held for the Court that, "When two or more persons have a common interest in a security, equity will not allow one to appropriate it exclusively to himself, nor to impair its worth *to others*." It is common knowledge that seizure under execution of railroad property not covered by a mortgage impairs the worth of the mortgaged railroad to the bondholders, and no one of them should be allowed thus selfishly to injure those with whom he has entered into a trust relationship.

The principle recognized in these decisions of our highest court and challenged in this latest action should be protected in express terms, and it might be proper to provide that no bondholder proceeding thus separately at law for his own benefit, should be entitled to share in the proceeds of the property covered by the mortgage or pledge; certainly not in any way that should give him an advantage over his fellow bondholders.

The provisions of the mortgage being for the benefit of the trustee and the bondholders on the one part, and of the mortgagor company on the other part, grave difficulties might arise

¹ 24 How. (U. S.) 263; 1860.

² 23 How. (U. S.) 117; 1859.

³ 21 Wall. (U. S.) 616; 1874.

48 PREPARATION OF CORPORATE BONDS, MORTGAGES

if under any rule of law¹ third persons were invested with any right to claim that any provisions of the mortgage were intended for their benefit. To avoid any such contention or any consequent enforcement of such a contention, the mortgage should provide in express terms that nothing in the indenture or the bonds is intended to give to any such third persons any rights whatever, and that the provisions of the bonds and mortgage are solely for the benefit of the parties thereto and the holders of bonds thereunder.

The draftsman should include in the mortgage (with concise reference thereto in the bonds) full exemption from liability on account of the mortgage debt on the part of incorporators, stockholders, officers and directors.

VII. *Releases and Leases*

The points to be covered in the article concerning releases are (a) the character and extent of the property subject to release; (b) the identification of the specific parcels and the ascertainment of their value; (c) the application of the proceeds of released property; and (d) the subjection to the mortgage lien of new property acquired with proceeds of releases.

The character and extent of the property permitted to be released depends of course upon the character of the property of the mortgagor and the nature of its business.

The general provision is one that the property released shall be such as shall not be necessary or advantageous for the operation, maintenance or use of the railroad or of the manufacturing plants, as the case may be, and that the release must be required for the purpose of carrying out an agreement for the sale of the property to be released or for the exchange thereof for other property, or as an incident to some change or modification in right of way or terminals, or in the adjustment of boundary disputes.

¹ Like that in *Lawrence v. Fox*, 20 N. Y. 269; 1859.

These facts should be made the subject of proof to the trustee by a resolution of the directors authorizing the company to request the release and a certificate of one or more officers of the company, having knowledge in the premises, setting forth the above facts concerning the property, as well as a specific description, and a statement of the value, of the property affected. In the case of railroad mortgages, it is usual to accept the certificate of responsible officers. In case of manufacturing or commercial companies, the release clause is further limited by requiring that there be furnished to the trustee further proof through appraisers or examiners satisfactory to the trustee.

Properly the proceeds of all released property should be held by the trustee, though the mortgage may authorize the company under proper safeguards to retain such moneys to be applied by it within a reasonable time for specified purposes. Obviously these purposes must be such as shall protect the security of the debt either by redemption of bonds or by enhancing the value of the mortgaged property.

The mortgage should require that new acquisitions be conveyed properly to the trustee as part of the security, or that the trustee should be entitled to rely upon the opinion of counsel that no such conveyance is necessary.

Express provision should be made that the purchaser of released property should not be required to see to the application of the proceeds or to the necessity of release.

Generally there is reserved to the mortgagor full power without notice to the trustee to dispose of worn-out machinery and other chattels upon condition that the same be replaced by new property.

In mortgages of railways, power should be reserved to the mortgagor to make changes or substitutions of trackage rights, agreements and contracts subject to the indenture, and, if there be important leases or contracts which are to be subject to no modification or subject to modification only with the con-

50 PREPARATION OF CORPORATE BONDS, MORTGAGES

sent of the trustee, they should be specifically excepted from the general clause. In a railroad mortgage, usually it is desirable to include in the grant in general terms all the so-called "structural contracts" in order that in case of foreclosure the entire property may be taken over as a going concern. Among the contracts which would be included in such an omnibus clause undoubtedly may be many which are subject to frequent change; and while it is desirable to mortgage all these contracts it is still more desirable that the operating efficiency of the road should not be hampered by preventing their modification. The railroad company also should reserve liberty to make changes of tracks, terminals, etc., to meet the requirements of municipal and other governmental authorities, even though, because of the absence of any equivalent property, the changes may involve some apparent reduction in the money value of the mortgaged premises.

The release clause should provide for the termination of the mortgagor's rights thereunder in case of default, subject to a discretion and right in the trustee to permit such a release after default and even after the company may have passed into the hands of a receiver. As already considered, the value of the mortgaged property as security lies largely in its earning capacity as a going concern, and anything that impairs its successful operation either in the possession of the mortgagor or of a receiver will result in loss to the holders of the mortgage bonds.

Any power to lease the mortgaged property or the property of any company whose stock is pledged should provide that in case of foreclosure and sale the lease should be terminable at the option of the purchaser.

VIII. *Consolidations, Mergers and Provisions Affecting the Mortgagor*

As most mortgages provide for the issuance from time to time of additional bonds, either those increasing the mortgage

debt or those issued upon interchanges of one form of bond for another, it is important to anticipate the effect of the mortgaged premises passing to another legal corporate entity as the result of a consolidation or a merger or of a sale of the premises as an entirety, especially if the mortgage contains the usual covenant that the mortgagor company will maintain its corporate existence and preserve its corporate property. Upon a strict merger under the New York Stock Corporation Law,¹ the obligations of the merged company are enforceable only against it, and not against the company into which it is merged.² This would seem to be the case also in respect of a merger of railroad corporations under the Railroad Law,³ thus differing in effect from a merger of banking corporations under Sections 35-40 of the Banking Law.⁴

For market purposes all bonds of the same series should be substantially identical in form, and therefore provision should be made for the issue of bonds in the name of the original corporation notwithstanding any such loss of its identity.

A few years since, in a case where it was proposed to consolidate a railroad company but to retain the right under an existing mortgage to issue a residue of bonds, it was decided that prior to the consolidation the mortgagor company should actually execute and have certified all the unissued bonds and place them in escrow for issue as provided in the mortgage. A comparatively recent case has taken the view that in such case the bonds could not be issued by the successor.⁵ This cumbrous procedure would have been unnecessary if the indenture had contained a clause authorizing a successor corporation to issue bonds in the name of the original mortgagor. This point should be covered by mortgage provisions to the effect that nothing therein contained should prevent any con-

¹ Sec. 15, Ch. 61, N. Y. Consolidated Laws.

² *Irvine v. N. Y. Edison Co.*, 207 N. Y. 425; 1913.

³ Sec. 149, Ch. 49, N. Y. Consolidated Laws.

⁴ See *Matter of Bergdorf*, 206 N. Y., 309 1912.

⁵ See *Diggs v. Fidelity Co.*, 75 Atlantic Rep. 517; 1905.

52 PREPARATION OF CORPORATE BONDS, MORTGAGES

solidation or merger or any conveyance or transfer of the property subject to the indenture as an entirety, provided that the lien and security shall not be impaired and that the successor corporation shall have assumed the payment of the bonds and the obligations of the indenture. Upon such assumption the successor corporation is authorized to issue such residue of bonds either in its own name or in the name of the original obligor.

IX. *Provisions Concerning the Trustee*

Theoretically the trustee of a corporate mortgage ought to have an active supervision of the trust; but practically the liabilities which in such case it would assume would be altogether out of proportion to the compensation which mortgagors are able or willing to pay.¹ In fact, the compensation paid to trustees for services prior to defaults are merely a reasonable sum to cover the value of supervision and clerical work in connection with the issue of bonds.

Accordingly, the responsible trust companies in New York require provisions granting them immunities from the strict duties of a trustee. They assume no responsibility for acts of agents selected with reasonable care, or for anything except willful misconduct or gross negligence. They assume no duty to see to the use of bonds delivered pursuant to the provisions of the indenture nor for the validity of the bonds nor the value of the security. They are not to be bound to take any action toward the enforcement of the trust unless notified of default by bondholders and furnished with satisfactory indemnity against expense, nor required to take any action unless specifically requested so to do by a specified percentage of the bondholders, usually 10 per cent to 25 per cent. They are to be protected in acting upon any instrument believed by them to be genuine, and are entitled to advice of counsel at the expense

¹ See *Rhineland v. F. L. & T. Co.*, 172 N. Y. 519; 1902.

of the mortgagor. They assume no responsibility for recitals and statements in the indenture, and make no covenant as to the rights of any person thereunder, nor are they to be responsible for the recording or other registration of the indenture, nor for the maintenance of insurance of the mortgaged property.

Provisions should be inserted for the removal or the resignation of the trustee. The usual provision is that the trustee may resign at any time by its own act or may be removed by writing under the hands of more than a majority or more than three-fourths of the bondholders, as desired. In case of the trustee so ceasing to act, it is usual to authorize the mortgagor company immediately to appoint a successor, subject to such appointee being superseded by a trustee appointed by a majority or more of the bondholders.

It should be provided specifically that in case any corporate trustee is taken under the control of a public officer or of a receiver, a new trustee may be appointed. In one instance where a corporate trustee was in the hands of the State banking department, it was considered as having the power neither to resign nor to act under the mortgage. Provision should be made also that a corporation succeeding the corporate trustee by merger or consolidation *ipso facto* shall succeed to trusteeship under the indenture.¹ This result is accomplished in case of merger by a statute of this state; but, notwithstanding, the counsel of several railroads having property in Western States have considered it necessary, in the absence of such a provision, to have executed and recorded a supplement to the indenture establishing the transfer of title on the record.

If an individual trustee be associated with the corporate trustee the indenture should limit the powers and duties of the individual trustee. So far as law will permit, the corporate trustee always should have the custody of stocks, bonds and

¹ See *Matter of Bergdorf*, 206 N. Y. 309; 1912.

54 PREPARATION OF CORPORATE BONDS, MORTGAGES

moneys, and also all powers in respect of the certification of bonds. Any notices or writings delivered to the corporate trustee should be deemed as having been delivered to all the trustees, and the individual trustee should be authorized to constitute the corporate trustee his attorney to do such acts as may be lawful. The individual trustee should be subject to removal at any time by joint act of the mortgagor and the corporate trustee, provision being made also for the appointment of his successor.

If an individual trustee be not appointed, it is prudent to include in the indenture an express provision authorizing the appointment by joint action of the trustee and the company of an individual trustee whenever required by the law of any jurisdiction in which mortgaged property is situated, or in case the corporate trustee shall deem it in the interests of the bondholders. Of course if the trust under the mortgage has once taken effect, the statutory disqualification of the corporate trustee would not prevent the enforcement of the trust through a qualified trustee appointed by the court, but it is preferable that the appointment of the qualified trustee should be made by the company and the representative of the bondholders rather than by the court. The object to be accomplished, where statutes require the appointment of an individual trustee, is to name such a trustee in the instrument originally, giving him only such powers as relate to the enforcement of the indenture against the property by entry or legal proceedings. Thus the grant to him would be effective to constitute a trust, even if the grant to a corporation foreign to the jurisdiction in which the property was located would be void under a statute. If the trust has once taken effect, it does not matter much whether the individual trustee resigns or is removed or dies. No new individual trustee need be appointed until action against the security is desired, and in such case such appointment should be within the power of the corporate trustee or the company or both.

X. Possession Prior to Default, Defeasance and Notices

In the early mortgages, these essential provisions were set forth at the beginning of the instrument, but now they are generally relegated to the end. The company should have the right to retain possession, and to operate the mortgaged premises, and to collect and enjoy the earnings. However, if part of the security consists of pledged bonds or stock, or in case any cash is to come into the possession of the trustee under the indenture, such security or cash should be retained by the trustee to be administered under provisions specifically relating thereto.

The usual defeasance clause is to the effect that when the whole amount due and payable on the bonds for principal and interest and all other obligations under the indenture are discharged, the estate of the trustee ceases, and at the expense of the company the trustee is to cancel the indenture and to execute any conveyances or reassignments, and to deliver to the company any personal property held by the trustee. The clause is desirable principally for convenience of proof that the indenture is a pledge or a mortgage, for if it be such, any proof to that effect will establish the right of the obligor to a return of the property on full payment of the debt.

The manner in which notices and requests to the trustee shall be executed by the bondholders and the method of conclusively establishing ownership of the bonds in respect of which the writing is made should be clearly set forth.

XI. Acceptance of the Trust

The formal acceptance of the trusts by the trustee is a statement that such trusts are accepted upon the terms and conditions of the indenture. Ordinarily such acceptance does not bind the trustee by the covenants of the mortgagor¹ but it is usual also by express disclaimer to guard this point.

¹ *Rhineland v. P. L. & T. Co.*, 172 N. Y. 519; 1902.

XII. *Execution, Acknowledgment, Etc.*

The instrument closes with a proper attestation clause signed by each of the parties by the officers authorized by the resolutions, and the corporate seal is attested by the secretary or other custodian. Pennsylvania requires that the instrument shall contain an express power of attorney to specified persons to execute. Many of the states require that the instrument should be witnessed by two or more witnesses.

Care should be taken that the acknowledgment or proof of the instrument complies with the requirements of the recording statutes in each and every jurisdiction in which any part of the mortgaged property is situate. In some cases it is considered preferable to have a separate acknowledgment executed in statutory form for record in each such State. In South Carolina proof is required instead of acknowledgment. Where proof is required, strict compliance with the statute is necessary, failure to state the place of residence of the subscribing witness being regarded in some jurisdictions as a fatal defect. A defective proof or acknowledgment generally vitiates the record as constructive notice, and in some jurisdictions the conveyance itself.

The officer before whom the acknowledgment is taken should be disinterested, for in many jurisdictions it is considered that if he be an interested party he is disqualified from acting in this *quasi* judicial capacity. Corporate mortgages have been denied the protection of the recording acts, when acknowledged before a notary public who was also a stockholder in the trustee corporation or even in the mortgagor corporation, though not so in New York.¹ It is said also that the acknowledgment should not be taken by the attorney for either the mortgagor or the trustee.

In many of the Western and Southern States there is a requirement that all mortgages covering personal property shall

¹ *Canandaigua Academy v. McKee*, 90 N. Y. 618-629; 1882.

contain an affidavit by the mortgagor and the mortgagee that the instrument is made in good faith to secure a specified debt and not with any design to hinder, delay or defraud creditors. The statutes should be consulted as to the form of such affidavits and to ascertain whether or not they are required to be recorded with the instrument.

Of course, there should be a prompt and formal delivery of the instrument to the trustee or its agent, and in many jurisdictions a record within a specified period after delivery. In some jurisdictions the record of the mortgage by the mortgagor is deemed *prima facie* evidence of delivery, but as this is refutable it is better that actual delivery be made.

Collateral indentures, debentures, income bonds and guarantees and Stock Exchange Rules will next be considered.

Collateral Trust Indentures

The term "Collateral Trust Indenture" is understood usually to refer to agreements whereby corporate bonds or stock or both are pledged or assigned in trust to a trustee as security for a series of notes or bonds. The pledge of such collateral securities almost always is a feature also of trust deeds covering realty, and repetition will be avoided by treating under this head of Collateral Trust Indentures, such pledges, when so included in deeds of trust, to which will apply also these provisions of pledge and the various provisions for the administration of securities so pledged.

Ordinarily, the stock pledged under such agreements is the stock of some company or companies subsidiary to the pledgor, and the bonds pledged are either those of such subsidiary companies, or long-term mortgage bonds of the obligor pledged as security for its own short-term notes. Security of the latter class is resorted to when short-time money is obtainable on better terms than long-time money. Accordingly, the corporation issues a series of notes payable within a few years,

58 PREPARATION OF CORPORATE BONDS, MORTGAGES

and secured by the pledge of its own long-term mortgage bonds, the expectation being that such bonds may be sold on favorable terms at the maturity of the notes, which then may be paid from the proceeds. Unless secured by mortgage such pledged bonds, being merely the obligations of the pledgor, would not constitute collateral security for the pledgor's own notes.

In case of bond issues secured by the pledge of stocks and bonds of companies subsidiary to the obligor, it is necessary to guard against possible dilution by the subsidiary company through an increase of its stock or the incurring of obligations having priority to the securities so pledged by the holding company. The protective provision usually inserted in the indenture is that there shall be no increase of stock unless there be pledged under the indenture such amount of the stock so added as shall be necessary to maintain thereunder the same proportion of the whole issue as that theretofore pledged under the indenture and either that no debt shall be incurred by the subsidiary company except in the usual course of its regular business, or else that if bonds or notes shall be issued either the whole amount or a portion thereof as stated shall be brought under the pledge. It is customary to provide also that any stocks and bonds of the pledged issues held by others at the time of the pledge but thereafter under any circumstances acquired by the pledgor shall be brought under the pledge. In every such case the indenture should authorize the cancellation and discharge of the indebtedness so brought under the pledge, thus restoring the original value of the pledged shares.

Sometimes a so-called holding company with a large number of subsidiaries desires to create a subordinate lien upon collateral theretofore pledged to and held by a trustee as security for an outstanding bond issue of the pledgor. This purpose is accomplished by assigning to a trustee the equity remaining in the pledgor company, and by providing for the appropria-

tion to the benefit of such subordinate debt, of the pledged securities, whenever they shall have been released from the existing pledge. Such a prior lien and such a secondary lien on pledged stocks and bonds were created by the two indentures of the United States Steel Corporation of 1901 and 1903 to the United States Trust Company, as trustee, which holds a vast amount of stocks and bonds as security for the two indentures in the order of their stated priority. This illustrates the desirability (indicated already in the previous reference to the Erie First Consolidated Mortgage of 1895 and the New York Central Mortgage of 1913) of having the same trustee in respect of indentures securing liens of different rank, by the pledge of stocks or bonds or other intangibles, for only by such actual holding by one trustee can there be perfected a technical pledge for the protection of the junior debt.

The trustee should be authorized to transfer registered bonds into its own name, to exchange coupon bonds for bonds so registered, and also to transfer into its own name, or into the name of its nominee, any shares of pledged stock.

But in pledging such bonds or stocks the pledgor corporation must guard two important points, viz. that unless or until it shall have made default, it may receive the income therefrom in the shape of dividends or interest, and to the fullest extent consistent with the special provisions of the pledge may exercise the voting rights in respect of the stock. This requires express provision, as under the general rule of law the pledgee would be entitled to have the income of the pledged securities applied towards the payment of the debt so secured.

As to income, the provisions ordinarily are that until default the pledgor shall have the right to collect the dividends and the interest, and, if necessary, to receive from the trustee appropriate orders for that purpose. These provisions should be qualified so that the pledgor company may not collect any interest or any dividends unless the same shall be paid out of the ordinary income of the issuing company or collect the

60 PREPARATION OF CORPORATE BONDS, MORTGAGES

same by legal proceedings, or retain any stock dividends, or exercise any rights in respect thereof except to collect and discharge the same. In the event that any sum shall become receivable on account of the principal of pledged bonds, or on account of pledged stock out of capital on distribution or dissolution, it should be provided that all such proceeds shall be received by the trustee and be applied to the improvement of the security either through the acquisition of additional property or by retirement of part of the secured debt. There should be further provisions empowering the trustee to enforce its rights as the holder of the pledged bonds and stock by legal proceedings in cases of foreclosure, dissolution or winding up, and also to make use of such stock and bond holdings to acquire the property of the company issuing the same. These provisions must be phrased with care and precision.

As to the reserved right of the pledgor to vote on pledged stock and for such purpose to receive proxies from the trustee, it will be well to specify that the pledgor shall have the right not only to vote but also to give the consent required under provision of any law, or by law or contract in respect of such pledged stock. Recently a trustee acknowledging its duty to give to the pledgor a proxy to vote at a corporate meeting in respect of the pledged stock, denied its power to give to the pledgor the equivalent power to execute the written consent authorized by the Stock Corporation Law in lieu of such meeting and vote. This technical construction required the delay, trouble and expense of calling a wholly unnecessary meeting of stockholders.

A privilege most convenient to the pledgor and by it often availed of, is that authorizing the use of pledged stocks and bonds in effecting consolidations or mergers of the company by which the same were issued, and allowing the requisite substitution of securities. The pertinent clauses should contain provisions for maintaining the value of the security, and requiring opinion of counsel as to legal effect of the proceedings.

Of course there can be no objection to permitting the pledgor company to acquire by merger or by purchase the property of any subsidiary company, if all property so acquired shall be subjected to the lien of the pledge.

There should be provisions authorizing the renewal or extension of pledged bonds, or the renewal or extension of any bonds by companies whose stock is pledged, subject to specified conditions intended for the protection of the security. The pledgor also should reserve the right to require a reassignment of pledged shares necessary to qualify directors.

The pledge should provide that the company issuing the pledged stock should not sell its property nor lease the same, except by a lease expressly conferring upon the trustee the superior right to terminate such a lease in case of default under the mortgage.

The collateral trust indenture, as well as a mortgage containing a pledge of stocks, generally contains various special stipulations as a result of negotiations between the issuing corporation and the intending buyer of the bonds to be issued. Such stipulations have no direct relation to the mortgage or other security, but are constituted covenants for the failure to perform which the remedies under the mortgage may be enforced.

Among such covenants are the following :

(1) *Sinking fund.* A valuable safeguard to the bondholder is a provision in the indenture requiring the obligor's amortization of its debt by annual payments into a sinking fund. In early mortgages, even of railroads, such sinking fund provisions were quite common, but later fell into disuse except in cases of mining, lumbering and shipping corporations and the smaller manufacturing companies. Recently, however, the desirability of providing for amortization of the corporate debt is being widely realized, and the vendibility of a bond is helped materially by the existence of a sinking fund, even though it be sufficient to retire only a third or a half of the debt.

62 PREPARATION OF CORPORATE BONDS, MORTGAGES

Broadly speaking, sinking funds are of two classes — (1) the ordinary sinking fund in which the moneys are applied to the payment and the cancellation of the bonds, and (2) the sinking fund known among bond dealers as “cumulative,” in which the bonds acquired by the use of sinking fund moneys are held in the sinking fund as enforceable obligations entitling the trustee to collect from the company the interest thereon as additional payments to the sinking fund. Under a cumulative sinking fund the moneys receivable increase from year to year and promote a rapid retirement of the debt.

To make really effective any sinking fund — necessarily any cumulative sinking fund — the bonds should be subject to redemption or purchase for purposes of the sinking fund, so that by calling a sufficient amount for redemption, if not otherwise obtainable, the moneys may be applied promptly to the acquisition of bonds.

In the absence of a redemption provision, the indenture should provide for the investment of the sinking fund moneys until bonds may be secured within the specified price.

The usual provision is to allow the company to make sinking fund payments either in cash or in bonds of the issue at a price not greater than par; and that any moneys received by the trustee may be applied by it to the purchase in the market of such bonds at a stated price, but not greater than the redemption price.

The sinking fund is established by a covenant to pay to the trustee under the indenture (or to a separate sinking fund trustee) on specified dates, annually or more frequently, amounts of money either specified or determinable. In the case of mining and lumbering companies and companies whose property is consumed in operation, the sinking fund should be based upon the consumption of the wasting property, measured either by actual exhaustion or computed upon the basis of the obligor's earnings from such wasting property. Where the value of the property depends upon franchises or leases, the

sinking fund should be calculated so as to retire the bonds prior to the termination of the franchises or leases. Such a sinking fund is illustrated in the Interborough Rapid Transit Mortgage of 1913.

If the sinking fund be cumulative, the company covenants to pay also the interest on the bonds acquired for the sinking fund when and as the same shall mature.

The indenture should provide that in case its purchase of bonds shall not exhaust the sinking fund, the sinking fund trustee shall determine by lot the numbers of the bonds to be redeemed; should specify the method of publication of notice of the redemption of the bonds called; and should recite that upon the presentation of the bonds, with all coupons maturing after the redemption date there shall be paid out of the sinking fund the amount due thereon for principal and premium.

The right to purchase or redeem all of the bonds at once should be reserved to be exercised in the same manner excepting of course the lottery for determination of bonds. It should be provided also that from the date to be fixed by publication of which holders of bonds would be bound to take notice, the earning of interest on all called bonds shall cease.

Unless it be intended that the accrued interest on the bonds also is to be paid out of the sinking fund, the indenture should provide that the interest obligations maturing on the redemption day should be paid in accordance with the terms thereof by the obligor out of its own funds.

The date for redemption customarily is an interest payment day, though of course this is a matter of convenience subject to agreement between the persons interested.

If the bonds are not subject to redemption for the sinking fund, provision should be made for the investment of the sinking fund moneys with adequate specification of the classes of investments and the powers of the sinking fund trustee in respect thereof.

64 PREPARATION OF CORPORATE BONDS, MORTGAGES

Of course any undue funding may accelerate the date upon which bonds may be called. This will not be permitted by the courts.¹ The right of the bondholder to continue his investment until payable in due course, is as inviolable as his right to receive payment at maturity. The right of the obligor to free himself from his interest-bearing debt when due either upon a named or accelerated date, as the stipulation may warrant, is similarly inviolable. These relative and conflicting rights must be made the subject of careful and adequate stipulations.

(2) *Redemption before maturity.* The right to redeem before maturity is a valuable privilege to the obligor, particularly one obligated to supply a sinking fund. The redemption price may be par or a premium over par. The redemption price is a matter of bargain between the obligor and the bond buyer. Usually it operates as a peg to stop the increase in the market price of the bonds, and therefore a redemption price high enough to leave some speculative possibility of increase in such market price is the usual insistence of the bond buyer. The longer the term of the bond the higher soars the redemption price. The redemption price varies from par up to ten per cent or fifteen per cent above par. Redemption provisions are disadvantageous also to the bond buyer in that he may fail to take timely notice of the publication of redemption and thus may lose some interest in an interval between investments. Except for purposes of a sinking fund, therefore, the more general provision is that the issue shall be subject to redemption only as an entirety or in comparatively large installments, and during a period beginning some years subsequent to the issue, and at a price estimated as probably equal to any advance in the market price of the bonds. The above comments on the calling of bonds for the sinking fund are pertinent also to redemption of bonds for retirement by the company.

¹ *M. K. & T. Ry. v. Union Trust Co.*, 156 N. Y. 592; 1898; *Harnickell v. Omaha Water Co.*, 146 App. Div. N. Y. 693; 1911.

(3) *The right to convert into stock.* As an aid to the sale of bonds sometimes there is given to bondholders the right, during a specified period, to convert the bonds into stock of the company at a specified rate. The right to issue convertible bonds and the rate of conversion are governed, of course, by the statutes affecting the corporation. When the corporation sells the bonds at less than par, thus varying the actual as distinguished from the nominal consideration for the stock issuable, the question as to whether, under the local rule of law, the discount or underwriters' commissions or other deductions raise any question as to the full payment of the stock when issued, must be determined upon the facts and the law in each case.

As the exercise of the right of conversion affects the security of the bonds issued only by improving it by reducing the debt secured, considerable liberty may safely be allowed the corporation in fixing the terms of the conversion, even among different series of the same issue. Inherently, the right is an individual right of each bondholder as distinguished from his common right with other bondholders in the benefit of the security. Such being the case, provisions in the indenture restricting the right of enforcement of the covenants by joint action of a number of bondholders, should except the bondholders' right to enforce the conversion privilege. All conversion privileges should contain a covenant that the corporation will make such increase of its stock as may be necessary to provide for the conversion when made. Bonds converted should be canceled and not reissued. In case the bonds are redeemable, provision should be made that the company may not, by redeeming the bonds, destroy the conversion right without affording reasonable opportunity to the bondholder to make conversion. As observed above in the discussion of mortgage provisions, it is necessary to safeguard the conversion privilege so that if desired upon or after consolidation it may be exercised in respect of stock of the consolidated corporation.

66 PREPARATION OF CORPORATE BONDS, MORTGAGES

(4) *Maintenance of specified amounts of net quick assets.* Indentures creating no trust fund as security, or constituting merely a pledge or assignment of stock of subsidiary companies of the obligor, often contain a covenant that the obligor or subsidiary companies will maintain a specified percentage of net quick assets whereof verified statements are to be furnished periodically to the trustee, and that failure to maintain such assets shall constitute a default authorizing the declaration of the maturity of the principal of the bonds and the enforcement of all remedies. The object is to enable the bondholders to act in case the company is tending towards insolvency. If such a provision be inserted in the indenture, care must be taken to specify the method of computing the assets and the items to be included in the computation.

Debenture Agreements

In the United States, as already mentioned, the term "debenture" is understood to mean serial obligations of a corporation not secured by a specific mortgage, pledge or assignment of property. Of course a series of debentures may be issued without the execution of any indenture relating thereto. Prior to 1900 the few issues that had been made of such debentures were not accompanied by a trust agreement. In such case the rights and privileges given to bondholders were set forth at length in the obligation, thus making a somewhat lengthy instrument. Since an issue of debentures under trust agreements by the Lake Shore R. R. Co. and by the New York Central, the custom of adopting such agreements has become general. Originally in 1893 the General Electric Company made a large issue of debentures without an agreement, but at the time of the refunding in 1912 a trust agreement was executed.

Generally the trust agreement contains covenants additional to those providing for the registration or interchange of the debentures, intended for the benefit of the debenture holder.

Among such beneficial covenants may be mentioned those for the immediate maturity of the principal by declaration in case of default under other outstanding obligations, or in case of bankruptcy or insolvency or receivership, etc.; those that the debentures shall be secured equally or otherwise under any future mortgage made by the obligor; those requiring the obligor to maintain indicated amounts of quick assets or prohibiting increase of indebtedness. The trust agreement also may contain provisions, which may not be set forth in adequate detail in the debentures themselves, for the redemption or for the conversion into stock of the debentures. Generally in fact all provisions of a corporate mortgage, except those relating to the security and its enforcement, are appropriate and useful in the debenture agreement.

In the case of debenture issues the real difficulty presented is to insure their enforcement equally and ratably for the benefit of all holders, and to prevent preferences on the part of the company, or, in case of default, a race of diligence between holders. It is somewhat uncertain whether this can be accomplished satisfactorily without affecting the negotiability of the paper, if negotiable instrument laws are intended to limit flexibility in the form of negotiable instruments. Unless affected by the so-called uniform statutes, the general rule of law was that negotiability depended not only upon statutes but upon the custom of merchants, *i.e.* the law merchant. It certainly is the custom of merchants to regard a bearer debenture as negotiable even though it contains a provision limiting the right of individual enforcement. The English debentures contain on their face the recital that they are issued subject to conditions indorsed thereon, which are to be deemed part of the debentures, and although such provisions are not in accordance with the strict idea of negotiability it is there recognized that bearer debentures are negotiable instruments. This is in accordance with the popular understanding under which stock certificates are regarded as negotiable while they

68 PREPARATION OF CORPORATE BONDS, MORTGAGES

are merely assignable. The fact is that the term "negotiable" has a double outlook, one towards transfer by delivery; the other towards relief of the transferee from the prior defects of title. It is in the latter sense only that debentures are rendered non-negotiable by reason of the restrictions usual in the collateral indenture. No one would hesitate to deem them as transferable by delivery and in that sense negotiable.

In England it is a common practice to give to the holders of a majority or more of debentures the power to sanction certain modifications of the rights of the holders as a body, such power being exercisable by resolution at a meeting or by a provisional agreement for modification made on behalf of all and sanctioned in writing by a specific percentage. The object of conferring this power on the majority is to protect it against unreasonable conduct on the part of the minority and to prevent a defeat of a beneficial arrangement because unanimity cannot be obtained.¹

Though in the United States it is unusual to give to majorities of bondholders such a right to sanction modifications of the indenture, there is inserted here in many indentures including mortgages a provision that in case of default and to avoid a foreclosure and sale, the trustee may consent to a plan of reorganization which shall authorize the creation of a lien prior to that of the indenture for the purpose of obtaining necessary moneys; the authority being exercisable by registered holders of not less than four-fifths of the bonds by a writing directed to the trustee. The right is given only to registered holders in order that the consent may be properly evidenced, and of course any coupon bond may be registered for that purpose. The power generally is limited so that no bond shall be changed as to the amount of principal, or rate or date of payment of interest. Such agreement authorized to be made in behalf of all the bondholders is to be reduced to a written agreement between the company and the trustee and

¹ 3 Palmer Company Precedents, 162; 11th Ed., 1912.

in case of mortgages is to be recorded in the various jurisdictions as a modification thereof.

The United States Steel Corporation trust indentures contain unusual provisions for meetings of bondholders to take action upon proposed modifications of the indentures.

There may be inserted in the indenture also a provision that registered holders may direct the trustee at any sale under the mortgage to purchase the premises for the use and benefit of all the bondholders, and in such case to settle for the purchase price by receipting for the entire amount of the proceeds applicable to the payment of the bonds and interest, thus limiting bondholders' rights to a share in the proceeds of the premises so purchased. To that end the trustee may transfer the property to a new corporation to be organized as directed by the bondholders making such request, and thereupon shall distribute the securities according to any plan of reorganization so agreed upon by said bondholders.

(5) *Income bonds.* In connection with reorganizations, oftentimes in order to provide for the settlement of outstanding obligations of the predecessor corporation, it becomes necessary to issue promissory obligations upon which the interest charge shall be conditional upon the realization of adequate net earnings by the obligor. Seldom if ever are such bonds issued for new financing by a solvent corporation. The payment of interest sometimes is made conditional throughout the life of the bond but generally only during a limited period of years after issue. In the case of such bonds the covenant to pay interest may be made conditional upon the determination by the company that the amount has been earned, supplemented by specific provisions as to the method of computing the earnings for the purpose. Much litigation in respect of income bonds has arisen because of disputes as to the computation of the earnings, and too much care may not be given to avoid uncertainties. The case of *Mackintosh v. Flint &*

P. M. R. Co.,¹ between different classes of stockholders, illustrates the difficulty of determining the amount of net earnings, and the difficulty even greater of finding a judicial officer fully equal to solving the problem in the masterly manner of Judge Jackson in that case.

Guaranties

Corporate bonds are often guaranteed by other corporations. The validity of such guaranty by a strong company is a matter of serious concern to the taker of the bond of a weak obligor. Such a guaranty cannot be given by a corporation, as an accommodation, or merely because of some direct compensation by it received therefor.² It is valid only if authorized expressly by law,³ or for a legitimate purpose incidental to the main business of the corporation,⁴ such as the enhancement of the value of bonds owned by it, upon its sale thereof,⁵ or as part of its lawful agreement to purchase the shares or bonds of holders thereof,⁶ or for the protection of its property interest in the company whose obligation it so guarantees,⁷ though it is questioned whether a New York corporation could exercise such a power in this latter case, except by a vote of the holders of two-thirds of its stock.⁸ A general guaranty of negotiable paper is itself negotiable in the sense of being transferable or assignable.⁹ The guaranty inures to the benefit of the assignee of the principal debt even though not mentioned in the assignment.¹⁰

¹ 34 Fed. Rep. 582; 1888.

² *In re Romadka Co.*, 216 Fed. Rep. (U. S.) 113-114; 1914.

³ See *New York Stock Corporation Law*, Section 8 (N. Y. Consolidated Laws, Ch. 61).

⁴ *Holmes v. Willard*, 125 N. Y. 75-81; 1890.

⁵ *Olcott v. Tioga R. R. Co.*, 27 N. Y. 546; 1863; *Arnot v. Erie R. Co.*, 67 N. Y. 315; *R. R. Co. v. Howard*, 7 Wall. (U. S.) 392; 1868; *Rogers &c. v. Southern R. Ass.*, 34 Fed. 278; 1888.

⁶ *Windmuller v. Standard Co.*, 106 App. Div. (N. Y.) 246; 1905.

⁷ *Re N. Y. Car Wheel Works*, 141 Fed. (U. S.), 430; 1906.

⁸ *Stock Corporation Law*, Section 8 (N. Y. Consolidated Laws, Ch. 61).

⁹ *Clafin v. Ostrom*, 54 N. Y. 581; 1874; *Everson v. Gere*, 122 N. Y. 290; 1890; *Arents v. Com.*, 18 Gratt. (Va.), 750; 1868.

¹⁰ *Stillman v. Northrup*, 109 N. Y. 473; 1888.

Generally and almost always in this community it becomes desirable in order to enhance their marketability that corporate bonds of any important or long-term issue shall be listed by the New York Stock Exchange.

To effect such listing it is necessary to comply not only with the general rules of law, but also with the special rules of the Stock Exchange. This lecture will now close with a brief consideration of those rules.

New York Stock Exchange Rules

So far as they affect the form of the obligations, the rules of the New York Stock Exchange are intended solely for the protection of the holders and in the interest of free trading. Just as in the case of the securities themselves, from time to time the rules have been modified as experience has developed difficulties of observance. A revised edition of the rules is now in preparation and is about to be issued. Those who may be interested will find a copy of the rules in force always available at the Exchange. In our communications with the Committee, we have found it disposed to exhibit a liberal purpose to construe the rules broadly, and, when reasonably necessary, in exceptional cases, to waive strict compliance.

The objects to which the rules tend are the following:

(1) That all rights of the holders of obligations (other than in respect of the security) shall appear succinctly in the instrument itself and without the necessity of recourse to any other instrument.

(2) That irrespective of provisions for other places, payment and registration or interchange or conversion of the bonds and publication of notice of redemption, etc., shall be made in the Borough of Manhattan, City of New York.

(3) That the collective rights of the holders shall be protected by a trustee without adverse or divided interest.

(4) That the legality of the issuance of the securities shall be attested by reasonable evidence and the opinion of counsel.

72 PREPARATION OF CORPORATE BONDS, MORTGAGES

(5) That there shall be a safeguard against forged or unauthorized issues.

Many of the provisions involved have been referred to in the preceding discussion, but it may be useful to summarize them here under the several headings mentioned.

1. As to the completeness of the instrument in itself, a number of specifications are urged upon corporations by the Committee and generally are adopted. Thus, it is desired that there shall appear in the bond a summary statement of the rights of registration or interchange or conversion of bonds, of the period and place of publication of notice of redemption, of the conditions of redemption, of the amount of the issue and of the date of and parties to the indenture under which they are issued. As to the registration and transfer, the text of the bonds relating thereto should omit reference to any requirement of entry on the corporate books. If the bonds of the issue may be varied in respect of the rate of interest or other provisions, the bonds must have a serial designation distinguishing one class from the other.

If the bonds are subject to redemption, the coupons maturing after the earliest date of redemption must recite the promise to pay "unless the bonds shall have been called for previous redemption." In recent years the Committee has been quite firm in its position that in the case of all new issues, all coupons in form shall be strictly negotiable, which has led to the abandonment of the clause at one time generally incorporated in coupons to the effect that they were subject to the terms and conditions of the bond and the indenture under which it was issued. Of course, the independent character of coupons is qualified so long as they are attached to the bond or are in the hands of the same holder.¹

2. As to the place of exercise of their rights by bondholders, the Committee insists that either by provision in the obliga-

¹ *Watson v. Chicago, Rock Island & Pacific R. R.*, 169 App. Div. (N. Y.) 663; 1915.

tion when practicable, or otherwise by supplemental agreement with the applicant for listing, there shall be maintained in the Borough of Manhattan an office or agency where the bonds and coupons may be presented for payment and where all notices or demands for registration, interchange of bonds or conversion, may be given or made. Similarly, it is insisted that for a specified period in advance of any redemption date, publication of notice of redemption shall be made in newspapers published in the Borough of Manhattan.

3. As to the trustee, the general requirement of the rule is that there shall be an independent trustee for each issue of obligations by a corporation, and that no trustee shall be an officer or director of the issuing corporation. On this point, I do not think that the general opinion of counsel experienced in the workings of corporate mortgages accords with the position of the Committee. The greater part of the administration of a corporate mortgage is prior to any default or necessity for enforcement of the security. In case of necessity for enforcement of the security, the responsible trust company, holding conflicting liens, will resign all but a single one in favor of independent trustees. But as only a few of the many mortgages issued go to default, and prior to default, save in exceptional cases, there is no real conflict of interest between the holders of prior liens and subordinate liens, clearly it is in the interest of ease of administration to have as few trustees as possible representing liens on the same corporate property. Especially is this so in the case of pledges of corporate securities, such as has been made by the United States Steel Corporation under its indentures of 1901 and 1903 covering the same collateral security, both of which agreements name the same trustee. Again, it is to be remembered that the number of trust companies in the city of New York — especially those with experienced trust departments — is not great, and I doubt whether in the cases of the large railroad corporations it would be practicable to obtain separate corporate trustees of their general

74 PREPARATION OF CORPORATE BONDS, MORTGAGES

mortgages and of the many underlying mortgages. This is recognized by the Committee, and they have not undertaken to enforce resignations of trusteeships when consolidations or mergers of the mortgagors or of the trust companies have resulted in the same trustee succeeding to several trusts in respect of the same property.

4. As to the evidence of the legality of issuance of the listed securities, the requirement of the Committee is entirely reasonable that the legality shall be attested by opinion of counsel and by certified copies of the corporate proceedings and of the consents of the proper governmental authorities having jurisdiction.

With the intent of identifying listed bonds even when there exists the right of interchange of coupon bonds and registered bonds, the Committee from time to time have made rules requiring a recital to be indorsed on registered bonds substantially in the following form :

“The within bond is issued in lieu of or in exchange for (a) coupon bond(s) numbered * * * for \$1000 (each), not contemporaneously outstanding, and (a) coupon bond(s) bearing the said serial number(s) will be issued in exchange for this bond upon its surrender and cancellation.”

But a new difficulty in such identification was introduced by the issue of coupon and registered bonds of denominations of less than \$1000 each, all denominations being interchangeable. Various forms of legends have been placed upon these so-called “baby” bonds in an effort to identify them as being issued in lieu of a \$1000 bond of a specific number, but the bookkeeping complications in endeavoring to carry out the various plans have made them generally impracticable. At present all that the Stock Exchange requires is a recital that upon surrender and cancellation of “baby” bonds for that amount, there will be issued in exchange therefor coupon bonds for \$1000, reserved unissued for the purpose.

It does not seem necessary or advisable to set forth in the indenture the exact form of the recital, inasmuch as change in custom may make the requirement obsolete. The proper way would seem to be to insert in the indenture a provision that "baby" bonds may be identified by number or letter in accordance with such plan as may be adopted by the Company with the approval of the trustee and may have imprinted thereon a legend that it has been issued in lieu of or exchange for a bond of higher denomination not contemporaneously outstanding and the statement that such a bond is reserved for exchange, together with such other specification in the premises as may be required to comply with the rules of any Stock Exchange or to conform to usage.

5. To guard against unauthorized issues, it is required further that the certification and registration are to be made by an acceptable trust company and that the engraving of the securities and protection of the plates shall be in the hands of an acceptable engraving company.

The other items of the rules in respect to the form of the application for listing, balance sheets, list of officers, transfer agents, registrars and agreements to be made by the corporation with the Exchange as to notices of corporate actions affecting security holders and similar matters, are set forth in the rules of the Stock List Committee, a copy of which may be obtained at the Exchange at any time. The Secretary of the Committee will always be found desirous of conferring with counsel while the form of the securities and other instruments are in course of preparation, with the view of obtaining conformity with the rules.

While it has been the purpose of this paper to indicate substantially all the points to be developed in the preparation of a corporate bond and mortgage or indenture, it is to be remembered that it is not intended as a treatise, and that the

76 PREPARATION OF CORPORATE BONDS, MORTGAGES

authorities cited are such only as bear upon points of particular interest. It has not been practicable to outline all the many variations possible in such indentures, or to quote the customary phraseology of the instruments now in general use. Copies of the more recent trunk-line railroad mortgages are generally available for examination at the offices of investment bankers or at the principal offices of the mortgagor companies, if not otherwise obtainable. With such assistance, and the exercise of diligence and care, the preparation of effective and systematic corporate obligations and trust indentures should be a task much less formidable than it appeared to me when I undertook such work some thirty-five years ago.

THE FORECLOSURE OF RAILROAD MORTGAGES IN THE UNITED STATES COURTS

Paper read February 23, 1916, before the Association of the Bar of the City of
New York by James Byrne

ON January 1, 1912, the Judicial Code of the United States, under which the circuit court was abolished and the jurisdiction of the district court was enlarged, went into operation. As the almost invariable method in recent years of proceeding to foreclose a railroad mortgage has been in substance the same before and since the Code, in describing it I shall speak in the present tense as though there were no Code; and then tell the details in which the Code affects it.

I take the case of an insolvent railroad company operating in different states a railroad built up by purchases, leases and consolidations; and assume, as the fact is in all but very rare instances, that it wishes its property to be put in the hands of receivers.

The procedure is as follows:

A general creditor, at the suggestion of the railroad company, files a bill in behalf of himself and all other creditors, against the company in the proper United States Circuit Court, in which he alleges that

- (a) the defendant is a corporation organized and existing under the laws, and a citizen, of the state in which the suit is brought and the complainant is a citizen of some other state;
- (b) the principal operating offices of the defendant and a material portion of its railroad are in the district in which the bill is filed;
- (c) the defendant is indebted to the complainant;
- (d) the defendant is insolvent; and, as there are many creditors whose debts have matured or are about to mature and the defendant is unable to pay them, if the court does not take the assets of the defendant into its possession, attachments will be levied, judgments

obtained and executions issued, and the railroad of the defendant thereby dismembered and its property wasted.

(e) the matter in controversy exceeds exclusive of interest and costs the sum or value of three thousand dollars.

The prayer of the bill is that the court will administer the assets of the defendant and appoint a receiver pending the suit.

The company files an answer admitting the allegations and joining in the prayer of the bill.

On the pleadings the court enters an order appointing a receiver.

This bill is called the primary or principal bill; the suit the primary or principal suit; and the court in which it is brought the court of primary jurisdiction.

The creditor then files ancillary bills in every judicial district in which any part of the railroad lies or in which there is any substantial amount of other property of the railroad company. In an ancillary bill it is as necessary to allege diversity of citizenship as in the principal bill.¹ Such a bill contains the same allegations as the primary bill except that it omits (b)²; and in addition it alleges that the primary bill, a copy of which is an-

¹ As to the necessity of a bill in one jurisdiction brought in aid of a bill in another meeting all the requirements of an original bill, see the opinion of Mr. Justice Harlan in *Mercantile Trust Co. v. Kanawha & O. Ry. Co.*, 39 Fed., 337; 1889; and the comments upon this case of Judge Lurton in *New York P. & O. R. Co. v. New York L. E. & W. R. Co.*, 58 Fed., 268, 278-80; 1893. See also the statement in *Coltrane v. Templeton*, 106 Fed., 370, 374, C. C. A., 4th Circuit, 1901, that the bill brought in aid of the primary bill is an "auxiliary" bill and not an "ancillary" bill.

² It may be that a portion of the railroad of the defendant is in a state of which the railroad company is not a citizen. In that case the ancillary bill changes (a) of the primary bill to an allegation that the complainant and the defendant are citizens of different states. The appearance of the defendant would in any case be a waiver of the objection that suit must be brought in the district of which either complainant or defendant is a resident; but where the property is in the district no such objection lies, as in that case a citizen of one state may bring suit against a citizen of another state, although neither of them is a resident of the district and the defendant may be served by publication. *Jellinek v. Huron Copper Mining Co.*, 177 U. S., 1; 1900; Section 57 of the Judicial Code superseding the act of March 3, 1875, C. 137, Sec. 8, 18 Stat. at L. 472.

nexed, has been filed in the court of primary jurisdiction; that the defendant has answered it admitting all its allegations and joining in its prayer; that the court of primary jurisdiction has appointed receivers of the property of the defendant; and that some of the property of the defendant is in the district in which the ancillary suit is brought. The bill prays as in the primary bill; and in addition asks that the court will appoint as receivers under it the receivers appointed by the court of primary jurisdiction.

The defendant files answers in all the ancillary suits similar to the answer in the primary suit; and the different courts enter orders appointing as receivers the same persons named by the court of primary jurisdiction.

Some days or weeks or months later the trustee of the mortgage which is to be foreclosed files bills in the courts in which the creditor's suits are pending, and the receivers appointed under the creditor's bills are appointed receivers also under the foreclosure bills.

Why do things take this course? Why is it that the filing of a creditor's bill and the appointment of a receiver under it so almost invariably precede the foreclosure suit as practically to be a part of it?

For three reasons:

1. As a receiver under a bill to foreclose a mortgage is receiver only of the mortgaged property, it may be that, because it is unmortgaged, property useful, perhaps almost essential, to the best operation of the road will not come into his possession. Such property may be seized at law by creditors pursuing their legal remedies; and it may be claimed that the liens which they obtain by judgment, attachment or execution extend to property which the receiver claims under the mortgage. These troubles are avoided by beginning with a creditor's bill; for the receiver under that bill is, of course, receiver of all the property of the railroad company, mortgaged or un-

mortgaged, and the administration of the property, its marshaling and distribution are all in the equity court.¹

2. The mortgage is not always in a condition to be foreclosed. The railroad company may find itself without money to pay its bills at a time when no interest is due on the mortgage and there is no default of any kind justifying the beginning of a foreclosure suit. If a creditor's suit is not begun in the federal courts, not only may operation be interfered with by levies under attachments and executions, but a state court may appoint a receiver. State courts are in many ways not as well suited as the federal courts for the foreclosure of a mortgage of a railroad company or the administration of its assets, particularly where the railroad is in several states. Federal courts have had much greater experience in such litigation; their rules and procedure are comparatively settled and are substantially the same in all districts and circuits; their relations with one another are more intimate than those of state courts; and they accept more easily than state courts the position of ancillary courts.

3. There may be all sorts of jurisdictional difficulties in the way of a foreclosure in the federal courts. The trustee of the

¹ The following method of getting all the assets of a corporation* into the possession of the court under a bill praying for the foreclosure of a mortgage, without a separate creditor's bill, was recently adopted. The trustee filed a bill setting up the clause now common in trust deeds that upon default in the payment of principal the mortgagee should be entitled to recover judgment for the amount due; alleging that in order to preserve the unity of the business and to carry it on to the best advantage a receiver should be appointed of all the property of the defendant corporation; and praying that judgment should be entered in favor of the trustee for the whole amount due, that the mortgage should be foreclosed, that the property covered by the mortgage and any remaining property should be sold in separate parcels, and that the proceeds of all such sales should be distributed among those whom the court should find to be entitled thereto. On the consent of the defendants a receiver of all its property was appointed. The bill is a combined foreclosure bill and creditor's bill. Under Rule 26 of the new equity rules the plaintiff may join in one bill as many equity causes of action as he has against the defendant.

* Not a railroad corporation. References will include cases in which the mortgages are not railroad mortgages, the principle involved in them being applicable to the subject treated in this paper.

mortgage and the railroad company may be citizens of the same state. They are almost sure to be when the railroad company is a citizen of the State of New York; and when it is not, it often happens, owing to the growth in importance of trust companies of other states, laws requiring a local trustee, and the union of railroad companies into a consolidated corporation existing under the laws of several states, that the trustee, or where there are several trustees one of them, is a citizen of a state of which the railroad company is also a citizen.

Take the case of a railroad company operating a railroad from a point in Ohio to a point in Missouri: it may be a consolidated corporation existing under the laws of Ohio, Indiana, Illinois and Missouri. It is then for jurisdictional purposes in Ohio a corporation and citizen of Ohio; in Indiana a corporation and citizen of Indiana; in Illinois a corporation and citizen of Illinois; and in Missouri a corporation and citizen of Missouri.¹ It has made a mortgage to two trustees, one a Chicago trust company and another, a citizen of Missouri, an individual; the interest on the bonds secured by the mortgage has not been paid, and the trustees wish to foreclose the mortgage in the federal courts. The impossibility of maintaining suits in the federal courts of all four states is seen at once. In Ohio and

¹ *Railway Co. v. Whiton*, 13 Wall. 270; 1871. *Muller v. Dows*, 94 U. S. 444 447; 1876. *Clark v. Barnard*, 108 U. S. 436, 448, 452; 1883. See *Southern Ry. Co. v. Allison*, 190 U. S. 326, 1903, to the effect that where a statute of North Carolina provided that a foreign railroad company desiring to carry on business within the state must comply with certain provisions and on compliance should become a domestic corporation, a foreign corporation did not by complying with the statute become a citizen of North Carolina for purposes of federal jurisdiction.

In *Muller v. Dows*, 94 U. S. 444, the Court says: "A corporation itself can be a citizen of no state in the sense in which the word 'citizen' is used in the Constitution of the United States. . . . For the purposes of jurisdiction it is conclusively presumed that all the stockholders are citizens of the state which by its laws created the corporation. It is therefore necessary that it be made to appear that the artificial being was brought into existence by the law of some state other than that of which the adverse party is a citizen." It is, of course, usual to speak of a corporation as a citizen of the state under the laws of which it is organized.

Indiana the federal courts have jurisdiction, for of both those states the railroad company is, and each of the trustees is not, a citizen; but in Illinois and Missouri the federal courts have not jurisdiction, for the Chicago trust company and the railroad company are both citizens of Illinois, and the individual trustee and the railroad company are both citizens of Missouri.

Another case where a jurisdictional difficulty arises is where a junior mortgagee is a citizen of the same state as the trustee of a senior mortgage. If the latter begins a foreclosure suit, it is for practical purposes absolutely necessary that the junior mortgagee should be a party defendant, but if the foreclosure bill makes it a defendant, the jurisdiction of the court is ousted.

All these jurisdictional difficulties in the way of a foreclosure suit disappear when the first step is a creditor's bill; for a creditor may be chosen to file the bill who is not a citizen of any of the states of which any of the defendants are citizens or by any possibility may be claimed to be. And when a federal court takes possession by its receiver under the creditor's bill of the property of the railroad company, such possession draws to that court all suits and proceedings with respect to that property, regardless of whether or not in such suits or proceedings there is a diversity of citizenship.¹ A mortgagee applies in the creditor's suit for permission to file a bill to foreclose and when permission is given he proceeds exactly as in an ordinary foreclosure suit.

This method of getting the assets of an insolvent railroad corporation into the federal courts and of foreclosing its mortgages there, is so direct and effective, the question arises why it is only in recent years that its use has become so universal.

There are two reasons:

First, the doctrine that the mere fact of possession of the *res* by a federal court gives a mortgagee a right to foreclose in that

¹ *Wabash Railroad v. Adelbert College*, 208 U. S., 38, 54; 1908.

court and that the foreclosure suit when once begun proceeds in all respects as an entirely independent suit, while it follows logically from the principle that the court which first takes jurisdiction has the right to exercise exclusive jurisdiction and from the rules of equity pleading, was not widely or fully comprehended until the time of the decisions in *Morgan's Co. v. Texas Central Railway*, 137 U. S., 171, 201; 1890; *Compton v. Jessup*, 68 Fed., 263, 279-282; 1895; and *Continental Trust Company v. Toledo St. L. & K. C. R. Co.*, 82 Fed., 642; 1897. In the *Continental Trust Company* case Judge Taft after saying that the jurisdiction of the federal court over the foreclosure suit depended upon the possession of the *res* under the creditor's bill, added, p. 645:

"Such dependence does not throw both suits into hotchpot, and dispense with the ordinary rules of pleading and practice as to parties proper and necessary to each cause of action. * * * The parties to the original bill have no more right to intervene in the dependent cause than if the court had independent jurisdiction thereof. Hence the rule as to who may appear to a foreclosure bill and file answers is the same here as if the bill had in fact been an independent bill. In other words, the relation between the two suits is principal and ancillary only so far as that, without possession of the *res* in the former suit, the court would have no jurisdiction of the latter; but, having thus acquired and thus maintaining its jurisdiction in the second suit, the court proceeds in it without further regard to the pleading or course of the principal action."

Second, the creditor's bill is demurrable on the ground that it does not show that the complainant has exhausted his remedy at law by obtaining judgment and return of execution thereon unsatisfied; and while the general belief always was that such a lack of equity was available only to the defendant, and to him only on the threshold of the litigation, it was feared that a defendant who had not made the objection at the beginning might be allowed to do so later, or that some intervening creditor or stockholder might set up the defense, and get the proceedings dismissed.

These fears were ended by the cases of *Hollins v. Brierfield Company*, 150 U. S., 371, and *Central Trust Company v. McGeorge*, 151 U. S., 129, decided in 1893.

In the *Hollins* case the court said that while simple contract creditors of an insolvent corporation "cannot come into a court of equity to obtain the seizure of the property of their debtor and its application to the satisfaction of their claims," nevertheless "defenses existing in equity suits may be waived . . . and when waived the cases stand as though the objection never existed"; and that the defense that the complainants had not exhausted their legal remedies was waived if not made *in limine*.

In the *Central Trust Company* case the court held that where the defendant corporation by entering an appearance and joining in the prayer of the bill for the appointment of a receiver had waived the objection that the suit was not brought in the district whereof it was an inhabitant; inasmuch as the corporation itself had submitted to the jurisdiction of the court, it was not open to any intervening stockholder or creditor to set up the defense thus waived. The principle of the case is broad enough to cover any jurisdictional defense which can be waived such as that the complainant has not exhausted its legal remedies.¹

Before the *Hollins* case it was usual for some creditor to obtain judgment by confession, and after execution had been issued and returned unsatisfied, to file a judgment creditor's bill. This procedure was troublesome, especially when the railroad ran through many different districts, in each of which the preliminary proceedings took place. There was frequent delay which gave creditors a chance to obtain a preference through attachments or executions; and defenses were interposed controverting the validity of the issuing and return of the execution and denying the authority to confess judgment of the officers of the company who had done so.

¹ *Horn v. Père Marquette Railroad Company*, 151 Fed., 626; 1907.

Sometimes when a creditor took the chance of filing a bill before having exhausted his legal remedies, he would file the bill as a general creditor and join a stockholder as co-complainant and add charges of mismanagement in the hope that if it failed as a creditor's bill, it might be sustained as a stockholder's bill.

A method of its own was adopted by the Wabash, St. Louis & Pacific Railway Company in 1884. The company itself was the complainant, naming as defendants the trustees of its general mortgage, the trustees of underlying mortgages, the owners of railroads of which it was the lessee, in all some ninety defendants. The bill alleged that the railroad company was practically insolvent; that its line of railroad extended into many districts; that it was a consolidated corporation existing under the laws of many states; that it had placed mortgages upon all of its property; that it had bought different portions of its line from different railroad companies, which had all mortgaged their properties before the complainant had acquired them, and that it was the lessee of different lines, mortgages upon which had been made by the lessors before leasing them; that its entire property was being operated by another railroad company; that it had a large floating debt, and was unable to pay this debt or the interest upon it, and that it would be unable to pay the interest on some of its mortgages; that suits would be brought in different districts in which creditors would levy attachments and issue executions on judgments and its entire railroad system would be disrupted to the great loss of creditors, stockholders, and the public.¹ Upon this bill the court appointed receivers.

There was widespread criticism of these proceedings. The Missouri Supreme Court in a similar case ² said that the appointment was void and could be attacked collaterally;

¹ *Wabash, St. Louis & Pacific Railway Company v. Central Trust Company* 22 Fed., 138; 1884.

² *State ex rel. Merriam v. Ross*, 122 Mo., 435; 1894.

" . . . it is simply a petition by a debtor for the appointment of a receiver to manage and carry on its business, so that its creditors cannot enforce their legal rights in the courts of the country, and not a petition stating a cause of action either at law or in equity in which, as incident thereto, a receiver might be appointed. The filing of that petition no more instituted an actual controversy between contending suitors in court than would the filing of a copy of the Lord's prayer."

The Supreme Court of the United States, however, never condemned the procedure in the Wabash case. On the contrary, in a case ¹ growing out of the Wabash litigation, the court stated the provisions of the bill at length and said:

"The bill was obviously framed upon the theory that an insolvent railroad corporation has a standing in a court of equity to surrender its property into the custody of the court, to be preserved and disposed of according to the rights of its various creditors and, in the meantime, operated in the public interest."

and later ² cited the case in a way to indicate that it regarded the statement just quoted as an approval of the theory.

Why counsel adopted the method they used in the Wabash case it is hard to see. It would seem from an opinion of Judge Baxter³ to have been in the hope that on the bill and the cross-bill of the trustees of the general mortgage the court might be induced to make a decree directing a sale of all of the property of the company free from underlying liens and distribution of the proceeds among all persons interested in some equitable manner to be determined after the sale, and that the making of such a decree would force all parties in interest to assent to a speedy reorganization.

Notwithstanding the criticism of the Wabash method, it was not infrequently followed; and a very good reason for following it arose when the Circuit Court of Appeals for the Ninth Circuit decided in *Chapman v. Atlantic Trust Company*, 119

¹ *Quincy M. & P. Co. v. Humphreys*, 145 U. S., 82, 95; 1892.

² *Re Metropolitan Railway Receivership*, 208 U. S., 90, 111; 1908.

³ *Wabash, St. Louis & Pacific Railway Company v. Central Trust Co.*, 22 Fed. 138; 1884.

Fed. 257, 1902, 145 Fed. 820, 1906, that the complainant in a suit in which a receiver was appointed was liable for the indebtedness of the receiver incurred to preserve the estate and for his compensation and lawyers' fees, to the extent that the assets of the receivership were insufficient.

If this decision was correct, there was no reason why the complainant should not be liable for the indebtedness of the receiver for whatever purpose contracted if it exceeded the amount realized from the assets. What such a liability might be no one could tell. In the case, for instance, of the Oregon Pacific Railroad Company there were, I believe, receivers' certificates to the amount of a million dollars or so upon which the holders received only an insignificant dividend. The possibility that a trustee for bondholders who had filed a bill for foreclosure, or a creditor for five or ten thousand dollars who had consented to let his name be used as complainant in a creditor's bill, might ultimately be held for some huge amount, was enough to make any one who considered the subject think with favor of the Wabash method of obtaining a receivership. If to be a complainant was to run such a risk the most suitable complainant undoubtedly was the insolvent railroad company itself.

Fortunately, the Supreme Court in *Chapman v. Atlantic Trust Company*, 208 U. S., 360, 1908, reversed the Circuit Court of Appeals, and held that the mere fact that a complainant had asked and obtained the appointment of a receiver was not sufficient to justify the court in holding him liable for debts of the receivership. This case and the case of *Re Metropolitan Railway Receivership*, 208 U. S. 90, 1908 — in which the Supreme Court held that so long as the indebtedness of the defendant to the complainant was real and the diversity of the citizenship of the parties was real, there was a controversy of which the federal courts had jurisdiction and the parties were not guilty of collusion in arranging with one another for the bringing of the suit, for the admission of the allegations of the bill, or for the

appointment of receivers — have disposed of all the fears and doubts which the most cautious counsel felt in proceeding by general creditor's bill to bring the property of an insolvent corporation into the federal courts.¹

Having now shown the usual method by which an insolvent railroad corporation is placed in the hands of a receiver and the reasons why that method, after trial of others, has been adopted, I take up the procedure more in detail.

When the interests of creditors and stockholders really require a receivership, it is of the utmost importance, in order to prevent unfair preferences or interference with the operation of the road by seizure under attachments of rolling stock, that all necessary applications to the courts should be made as quickly and quietly as possible.

If the railroad and all the other property of the company are in a single district, it is a comparatively simple matter: the filing of a bill and answer and the appointment of a receiver in that district. But, except in the case of street railway companies, the property of a railroad company is usually in many districts; and therefore it is necessary to file many bills and obtain under every bill a receivership order. This necessity arises out of the fact that the jurisdiction of a federal court is

¹ See also *Dickerman v. Northern Trust Company*, 176 U. S., 181, 192, 1900, "if a person takes up a *bona fide* residence in another State, he may sue in the Federal court, notwithstanding his purpose was to resort to a forum of which he could not have availed himself if he were a resident of the State in which the court was held"; *Blair v. City of Chicago*, 201 U. S. 400, 448-9, 1906, "As to the conspiracy to get the case into the Federal Court, with a view to the decision of the rights of the parties therein, we are not aware of any principle which prevents parties having the requisite citizenship and a justiciable demand from seeking the Federal courts for redress. . . . It is true that the judgments were taken and the receivers appointed the same day, and it is quite likely that the receiverships were in view when the judgments were taken and that preparations had been made in that direction, but we perceive in this no legal objection to the jurisdiction of the court"; and *In re Cleland*, 218 U. S., 120, 1910, holding that a federal court had jurisdiction of a suit where the shares of stock owned by the complainant had been transferred out and out to him for the express purpose of enabling him to sue in that court.

confined, in the absence of some statute extending it, within the territorial limits of a judicial district¹ and that as a chancery receiver takes no title to property, but is only an officer of the court which appoints him, he has no jurisdiction which that court has not.

In *Great Western Mining Company v. Harris*, 198 U. S., 561, 1905, the Supreme Court, after saying that it was held in *Booth v. Clark*, 17 How. (U. S.), 322, 1854, that in the absence of some conveyance or statute vesting the property in him, a receiver cannot sue to recover property in courts of a foreign jurisdiction even when authorized by the court which appointed him² adds, page 577:

"It is doubtless because of the doctrine" of *Booth v. Clark*, "that the practice has become general in the courts of the United States, where the property of a corporation is situated in more than one

¹ Section 742 of the Revised Statutes (now Section 55 of the Judicial Code) is an example of a statute extending the jurisdiction of a federal court beyond the limits of the district.

"Any suit of a local nature, at law or in equity, where the land or other subject matter of a fixed character lies partly in one district and partly in another, within the same State, may be brought in the [circuit] district court of either district; and the court in which it is brought shall have jurisdiction to hear and decide it, and to cause meane or final process to be issued and executed, as fully as if the said subject matter were wholly within the district in which such court is constituted."

A suit to foreclose a mortgage is a suit of a local nature, and so, as was decided by Judge Lurton in *Horn v. Pere Marquette Railway Company*, 151 Fed., 626, 1907, is a creditors' bill to administer the property of an insolvent railroad. In that case Judge Lurton held that as the Pere Marquette Railroad Company was in both districts in Michigan, a receiver appointed in a creditor's suit in one district had jurisdiction and control of the property of the company in the other.

² A statutory receiver does not always get title to property, but he does very frequently, and when the cases or textbooks speak of a statutory receiver in contradistinction to a chancery receiver they generally mean a receiver in whom all of the property of the corporation vests by the terms of the statute which authorizes his appointment — a receiver, for instance, appointed under the provisions of Sections 65-68, of the New Jersey Corporation Law, or of Sections 106 and 191 of the General Corporation Law of New York. In *Keatley v. Furey*, 226 U. S., 399, 403, 1912, the Court said, "The effect of such a provision" — that a receiver should have title — "need not be considered in this case. In some instances, at least, it would be enforced outside of the State. *Bernheimer v. Converse*, 206 U. S., 516, 534; 1907. *Converse v. Hamilton*, 224, U. S. 243, 257; 1912." In the cases cited, it was held that a statutory receiver might sue in a foreign jurisdiction.

jurisdiction, to appoint ancillary receivers of the property in such separate jurisdictions. It is true that the ancillary receiverships are generally conducted in harmony with the court of original jurisdiction, but such receivers are appointed with a view of vesting control of property rights in the court in whose jurisdiction they are located."

It follows from what has been said that the property of the railroad company in all districts the jurisdiction of which is foreign to the districts where a receiver has been appointed is subject to the liens of judgments, executions and attachments to the same extent as if no receiver had been appointed in any district. The interval, therefore, between the appointment of the receivers in the principal district and their appointment in all other districts where there is property of the company should be shortened as much as possible. To this end action is taken as follows:

When the directors, principal officers and counsel of a railroad company see that a receivership is inevitable, some creditor is told who can be trusted not to take advantage of the information in order to get a preference for himself by attachment or other process and is asked to file a general creditor's bill. The creditor's lawyer and the counsel for the railroad company then prepare the necessary papers.

The principal bill, the answer to it and the order appointing receivers under it are first prepared. They are entitled in the circuit court (it will be remembered that I am assuming the Judicial Code which abolished the circuit court has not gone into effect) for the district where the principal operating offices of the railroad company and some material part of the mortgaged railroad are situated. For that court has been held by four justices of the Supreme Court¹ to be the court of primary jurisdiction and of principal decree. Ancillary bills to be filed in the courts of all districts where any part of the railroad or other real property or money or securities are situated, answers to them, and orders appointing receivers under them are then pre-

¹ *Farmers Loan & Trust Co. v. Northern Pacific R. Co.*, 72 Fed. 26; 1896.

pared. Each set of papers is entitled in the court in which they are to be used.

When all these papers have been prepared, a meeting of the directors of the railroad company is held, at which the different bills and answers and orders are presented and a resolution is passed directing counsel to appear in the principal and ancillary suits, to file answers substantially in the form of those that have been prepared, to consent to the entering of the proposed orders, and in general to do all things necessary and proper to the appointment of receivers in all jurisdictions where any of the assets of the company are situated.

Counsel for the complainant and the defendant then take the papers in the suit in the court of primary jurisdiction and in the ancillary suits in the other courts of the same circuit to one of the circuit judges of that circuit. Usually it is of importance, and the court is willing, that some one connected with the railroad in an operating capacity should be a receiver. The court ordinarily appoints as a co-receiver some one not previously connected with the railroad of whose fitness it has personal knowledge. When the court decides upon the receivers it signs the order of appointment and delivers the papers to the clerk of the court or mails them to him or gives them to counsel to deliver to him. The pleadings in the ancillary suits are then verified and the ancillary orders appointing receivers are signed, and the assistants of counsel take them to the clerks of the various courts to be filed.¹

¹ In *Horn v. Pere Marquette R. Co.*, 151 Fed., 626, 1907, Judge Lurton said in regard to an order which he as circuit judge had made at his chambers in Cincinnati in a suit in the United States Circuit Court for the Western District of Michigan:

"An order appointing a receiver made at chambers . . . presupposes a pending case. The objection that there was no pending suit when the order in this case was made is a misconception. I am not at all inclined to agree that when the complainant's bill and the defendant's answer were exhibited to me at Cincinnati, and an application made by both parties for the appointment of a receiver, that this lodging of the pleadings with me and this consent by the defendants was not such a commencement of the suit and filing of the bill as to make my order relate

Meanwhile other assistants are waiting near a circuit judge in each of the other circuits where any substantial portion of the mortgaged property is situated with the papers in the ancillary suits which are to be filed there. As soon as a telegram or a telephone message tells them that the suit in the principal court has been begun and receivers appointed, the pleadings in the ancillary suits are verified and presented to the circuit judge having jurisdiction and he signs orders appointing receivers in all the courts in his circuit. The pleadings and the orders are then sent with all possible speed to be filed in the offices of the clerks of the proper courts.

How has the procedure I have been describing been affected by the Judicial Code? As follows:

First. — Formerly creditor's suits and suits to foreclose mortgages were brought in the circuit court. That court having been abolished by the Code, they are now brought in the district court.

Second. — Formerly a circuit judge could sign, wherever he happened to be in his circuit, orders appointing receivers in the principal suit, and in the ancillary suits for all the districts in his circuit, no matter how many states those districts might be in.¹ Now he cannot do this, and if to-day counsel deems it advisable in the case of an insolvent railroad company to file a creditor's bill in each judicial district through which the road runs, he should have the receivership order in each district signed by a judge — whether the district judge or a circuit judge designated to act as a district judge — actually

to the very time when I acted at Cincinnati. *Universal Savings & Trust Co. v. Stoneburner*, 113 Fed., 251; 51 C. C. A., 208; (1902). To save the question I made my order to take effect when the bill should be filed at Grand Rapids, and directed the clerk to then issue the necessary process. Thus the order was signed by me on December 4th. It was provisional upon the actual filing of the bill, and became effective then only. The pleadings were then intrusted to one of the counsel to be lodged in the clerk's office at Grand Rapids and this was done. . . ."

¹ *Horn v. Pere Marquette R. Co.*, 151 Fed. 626; 1907.

present, and having jurisdiction, in that district. The reason is this:

When the Judicial Code abolished the circuit court, it provided that the circuit judges should continue to hold their offices during the terms for which appointed. The duty of these judges is to hear and decide cases in the circuit court of appeals and to do whatever is necessary in connection with such appeal work. For the performance by them of any other judicial act some specific authority is needed. Section 18 of the Code provides that "Whenever in the judgment of the senior circuit judge of the circuit in which the district lies, or of the circuit justice assigned to such circuit, or of the Chief Justice, the public interest shall require, the said judge or associate justice or Chief Justice shall designate and appoint any circuit judge of the circuit to hold said district court." Section 19 provides that "all the acts and proceedings in the courts held by him, or by or before him, in pursuance of said provisions, shall have the same effect and validity as if done by or before the district judge of the said district." As a circuit judge, by such designation, gets the powers of a district judge and no others, it seems clear that no matter in how many districts he may have been designated to act as a district judge, a circuit judge has no longer the power he formerly had to sign orders when in one district of his circuit in suits pending in other districts.¹

Third. — Section 56 provides that if a receiver is appointed in a suit where the land or other property of a fixed character, the subject of the suit, lies within different states in the same

¹ In *Horn v. Pere Marquette R. Co.*, Judge Lurton intimated that it was a sufficient answer to the objection that the power of a circuit judge could not be exercised validly outside of the particular district in which the order was to be entered that the defendant company had joined in the application for the order and therefore neither it nor its creditors nor stockholders could object. See also *Continental Trust Co. v. Toledo, St. L. & K. C. R. Co.*, 99 Fed., 171; 1900. In the same way, it may perhaps be said that where the parties consent to a district judge or a circuit judge designated to act as a district judge, signing an order out of the district where he has jurisdiction and where the order is to be entered, the order cannot be subsequently objected to by any of the parties or any one claiming under them.

judicial circuit, the receiver shall upon giving bond immediately be vested with full jurisdiction and control over all the property, the subject of the suit lying or being within such circuit; subject, however, to the disapproval of such order, within thirty days thereafter, by the circuit court of appeals for such circuit, or by a circuit judge thereof, after notice to adverse parties and opportunity to be heard; and subject also to the filing in each district court of the circuit in which any of the property may lie or be, within ten days thereafter, of a duly certified copy of the bill and of the order of appointment. The Act further provides that in any such case in which a receiver shall be appointed, process may issue and be executed within any district of the circuit in the same manner and to the same extent as if the property were wholly within the same district; but orders affecting such property shall be entered of record in each district in which the property affected may lie or be.

Since this took effect, the general practice where a railroad is in several circuits is this: the complainant files the principal bill in the primary district; the railroad company answers and joins in the prayer of the bill; the circuit judge designated to act in that district or the district judge signs in that district the order appointing receivers and it is there entered; the complainant forthwith files certified copies of the bill and order in all the district courts of the circuit where there is property; the complainant also files, as soon as the order appointing receivers has been made in the primary district, an ancillary bill in one district of each of the other circuits and the railroad company files the usual answer; the district judge or designated circuit judge signs in that district an ancillary order appointing receivers and it is there entered, and the complainant files certified copies of the ancillary bill and order in all other districts of that circuit where there is property.

This is the practice adopted in the receiverships of the Chicago, Rock Island and Pacific Railway Company, the St. Louis and San Francisco Railroad Company, the Missouri, Kansas &

Texas Railway Company, the Missouri Pacific Railway Company and the Western Pacific Railway Company. In all these cases except that of the last named company the receivership is under the general charge of a circuit judge designated to act as a district judge.

As the powers of chancery receivers arising from the mere fact of their appointment are few, it is customary for the court in the order of appointment to give them express authority to do the things that experience has shown they ought to have the right to do if the receivership is to produce the best results. The order appointing receivers under the creditor's bill authorizes them :

(1) to manage and operate the railroad and other properties; and to exercise the franchises and to discharge the public duties of the railroad company.

(2) to institute and prosecute in their own names or in the name of the railroad company all such suits as may be necessary for the protection of the trust estate and to defend all actions instituted against them and to defend any suits to which the railroad company is a party, the defense of which is necessary for the protection of the estate;

(3) to pay wages and debts for current operating expenses and supplies incurred within six months prior to the appointment of the receivers;

and directs :

(4) the officers, directors and employees of the railroad company and all other persons to deliver up to the receivers all moneys and other property under their control;

(5) the railroad company and its officers and employees and all other persons to refrain from interfering with the possession or management of the property or interfering in any way with the receivers in the discharge of their duties;

(6) the receivers to give a bond for the faithful performance of their duties.

The following orders are sometimes part of the receivership order; if not they are entered almost immediately :

(1) An order naming the counsel of the receivers. Such counsel are chosen by the receivers subject to the approval of the court.

(2) An order requiring the receiver to file monthly reports and appointing a master to examine and pass upon them.

(3) An order requiring all creditors to present claims to a designated master before a fixed date; and directing that notice be published in certain newspapers; that a copy of the order be mailed to creditors who are on the books of the company; that any creditor be allowed to object to the claim of any other creditor; and that a hearing be had before the master on the date fixed in the order or on such other date as the master may name.

Notwithstanding the order of appointment may authorize the payment of all preferred claims, the only preferential payments the receivers actually make without a special order are of wages due employees and traffic balances of small amounts. Traffic balances of large amounts the receivers pay promptly, but not till they have obtained the permission of the court. Payments of supply claims and the like are not made until the right to a preference has been passed upon by a master and his report has been confirmed. It is well at the outset to have an order entered directing all creditors demanding a preference to make the demand when presenting their claims to the master, and permitting all other creditors to be heard in opposition to the demand. If such an order is not promptly made, creditors claiming a preference will file petitions of intervention; and in many courts orders allowing them to intervene will be entered almost as a matter of course, with the effect of unnecessarily multiplying proceedings. The practice adopted in this district is to require the individual creditors to file their claims with a statement of the preference they deem themselves entitled to, and, where there are many creditors, to permit committees to intervene who represent different classes of creditors claiming

a preference, contract creditors, tort creditors, and so on. In the New York City Railway receivership the intervening committees were made parties defendant to the litigation, thus obtaining the right to be heard on all questions, not merely on the question of their right to a preference.

It is of the highest importance that at the very earliest moment there should be in the files of the court, for its guidance and that of all parties in interest, as full and clear a report of what the court has in its hands for administration as the receivers and their counsel can quickly prepare with the aid of the accounting and other departments of the railroad company. This report should tell what the assets and liabilities of the company are, what mortgages are on the property, what they cover, when they mature and what defaults will accelerate their maturity, when the interest falls due, what car trust agreements there are, how much has been paid on them, what payments remain to be made, what rolling stock the company owns and whether it is too much or too little, what the earnings and expenditures have been for some years of the railroad as a whole, of leased lines, of branches, and of various divisions of the road. The report should not confine itself to the past, but should give the judgment of the receivers as to the prospects for the future and make suggestions as to the best way to get new business or hold what the road already has. The court sometimes authorizes the receivers to hire experts to aid them in the preparation of such reports.

One of the first questions presented to receivers is whether or not they shall pay interest on mortgage bonds, non-payment of which may accelerate the maturing of the principal. Some of the mortgages may be liens on all of the railroad, others may be divisional mortgages, as they are called, with liens only on a portion of the road. Some may cover parts of the main line, the loss of which would be irreparable; others may cover

branches not essential to the system, but valuable as feeders. The general practice is to pay the interest due on mortgages upon the main line senior to the mortgage being foreclosed; upon valuable links; upon branches which are clearly worth more than the mortgages upon them; and even upon mortgages covering parts of the property the value of which is doubtful, until the stockholders and general creditors or bondholders under junior mortgages have a short time in which to make up their minds what the best interests of the property require.¹

But the receivers may be quite sure that interest ought to be paid and find they have no money to spare for that purpose. In that case they present to the court a petition giving all the facts and arguments which have convinced them; and ask that they be directed to pay the interest and for that purpose to borrow money and issue receivers' certificates. The court sets down the petition for hearing and directs that notice of hearing be given to all parties and to the trustees of the mortgages on which it is a question of paying interest and of junior mortgages, whether such trustees are parties or not. The court, if it directs interest on bonds to be paid and receivers' certificates to be issued, orders that the certificates shall state on their face the lien which the court has given them, usually a lien just subsequent to the lien of the mortgage securing the bonds. To give the certificates a prior lien would be to pay the bondholders their interest at the expense of their mortgage.²

¹ In *Guaranty Trust Co. v. International Steam Pump Company*, 231 Fed., 594, 595, 1916, Judge Mayer said that when interest becomes due on a mortgage during a receivership under a creditor's bill, and a failure to pay it may entitle the trustee to declare the principal of the bonds due, the receivers ought to apply to the court for instructions.

² Of course the bondholders themselves for various reasons such as a desire to put off foreclosure and sale until times of business depression pass away and meanwhile to receive their interest, may be willing that the lien of the certificates should be placed ahead of their mortgage. If they are not willing that the certificates should be paid ahead of their bonds either out of net income to which they are otherwise entitled or out of the *corpus*, the bondholders

The court has power to issue certificates without notice to anyone.¹ Before, however, they are allowed to displace any existing lien, — before, that is, they are paid at the expense of any existing lien, — the lienor must be given a hearing. At the hearing it is not enough for him to show that he did not have

or their representatives should see that in the order and in the certificates it be declared that the lien of the certificates is subordinate to that of the mortgage, both upon income and *corpus*, and that the certificates are not to be paid out of either until after the payment in full of the principal and interest of the bonds. The importance of fully and explicitly defining the rights of the certificate holders and the bondholders, is shown by the case of *American Trust Co. v. Metropolitan Steamship Co.*, 183 Fed., 250; 1910; affirmed 190 Fed., 113; 1911; C. C. A., First Circuit. There, receivers' certificates had been issued to raise money in order to pay interest on bonds; the sale under foreclosure of the mortgaged property had not produced enough to pay the bonds, principal and interest, in full; a large amount of net earnings had been accumulated subsequent to the appointment of receivers in the suit to foreclose the mortgage securing the bonds. The court held that the receivers' certificates were payable out of the net earnings ahead of the amounts still remaining due on the bonds, notwithstanding the order and the certificates both provided that the lien on the mortgaged property of the certificates should be subordinate and inferior to the lien of the mortgage securing the bonds. There is language in the opinion of the court of appeals, page 116, which, it may be argued, means that even if the order and certificates had said in so many words that the mortgage was to be prior to the certificates in lien upon the income as well as to the *corpus*, nevertheless, the court would have ordered the certificates to be paid out of the income ahead of the bonds. And in *Union Trust Co. v. Illinois Midland Co.*, 117 U. S., 434, 480-1, the court said that, notwithstanding the orders and certificates provided that certain certificates should have priority over other certificates and receivers' debts, the final decree in that case should deny them such priority. It would seem in fairness to purchasers and all parties that the rights apparently given by the language of the certificates should not subsequently be altered. If it be said that such alteration may from the necessities of the case sometimes be necessary, the power to make it should be reserved by the court on the face of the certificates.

¹ "Though prior notice to persons interested, by notifying them as parties, first requiring them to be made parties if they are not, is generally the better way, yet many circumstances may be judicially equivalent to prior notice. A full opportunity, as in this case, to be heard on evidence, as to the propriety of the expenditures and of making them a first lien, is judicially equivalent." *Union Trust Co. v. Illinois Midland Co.*, 117 U. S., 434 at 456; 1886. "It was for the court to say whether the Canal & Irrigation Company should be kept on its feet by moneys borrowed or obtained under its orders by the receiver. The wishes of the parties could not control as to such matters. Indeed they need not in strictness have been consulted as to what should be done from time to time in the management of the property." *Atlantic Trust Co. v. Chapman*, 208 U. S., 360, 371; 1908.

notice before the certificates were issued. He must show such objections to the merits of the order as would have availed him if presented to the court before the order was entered. "The receiver and those lending money to him on certificates issued on orders made without prior notice to parties interested, take the risk of the final action of the court, in regard to the loans."¹ As a practical matter the court nearly always directs notice to be given to persons, whether parties or not, whose liens may be affected by the certificates, for whatever the power of the court may be, bankers hesitate to buy certificates unless all persons, who at any time may have a right to be heard on the question of their priority, are heard before they are issued.

Very frequently when the receivers under a creditor's bill take possession of a railroad, they find there are unpaid taxes, interest is running at a high rate, and heavy penalties are being incurred. If the court deems it essential to act at once, it will authorize certificates to be issued without notice to mortgagees, with the same lien as the tax levies. There is, of course, nothing unfair about this. It may be, however, that the issuing of such certificates will be a breach of some condition of a perfectly well secured mortgage, and the trustee of that mortgage may be thus enabled to foreclose for the face amount of the bonds secured by it, although the bonds may be selling in the market for sixty or seventy per cent of their par value. For that reason the certificates should not be given a lien ahead of any such mortgage, even if otherwise they can only be sold at a discount.

A question which a receiver ought to consider very promptly is what contracts he wishes to adopt because whatever the effect may be upon the *railroad corporation* of a disaffirmance, the *receiver* has an absolute right to disaffirm, and it is his duty to disaffirm, any executory contracts that are not beneficial.

¹ *Union Trust Company v. Illinois Midland Co.*, 117 U. S., 434 at 456; 1886.

This brings me to the question which arises where the insolvent railroad company is the lessee of other railroads and the entire system is in the hands of receivers of the lessee. What are the rights of the lessor and the rights and duties of the receiver?

The New York Court of Appeals has held¹ that the "principles which govern the liability of an assignee of a lease seem to be applicable to the case of a receiver;" and therefore the taking possession of the leased road by the receiver of the lessee makes him liable to pay the rental fixed in the lease during his occupation. This is not the law of the federal courts. That law is stated thus:² "If the order of the court, under which the receiver acts, embraces the leasehold estate, it becomes his duty, of course, to take possession of it. But he does not, by taking such possession, become assignee of the term, in any proper sense of the word. He holds that, as he would hold any other personal property involved, for and as the hand of the court and not as assignee of the term." Nor, the court adds, does actual operation of the leased railroad by the receiver render him liable under the covenants of the lease even for the time that he operates the property. He has a reasonable time to decide whether as receiver he shall adopt the lease.

The subject was thoroughly discussed by the Circuit Court of Appeals of the Second Circuit in the New York City street railway litigation.³ The court held in substance that during the trial period of operation of a leased road, the receiver was holding for the lessee or the lessor according as he ultimately adopted or rejected the lease — a logical conclusion from the principle so often stated by the Supreme Court, recently in *Atlantic Trust Company v. Chapman*, 208 U. S., 360, 1908, that a receiver is not appointed in behalf of any particular person, but "for the benefit of all parties who may establish rights in the

¹ *Woodruff v. Erie Railway Company*, 93 N. Y., 609, 624; 1883.

² *Quincy M. & P. Co. v. Humphreys*, 145 U. S., 82, 98; 1892.

³ *Pennsylvania Steel Co. v. New York City Railway Co.*, 198 Fed., 721, 728-34; 1912.

cause." When the receiver elects not to adopt a lease, it follows that the court during the trial period has been operating for the lessor; that the receiver therefore is not bound to pay rent for the trial period but only (in the absence of special equities — which may justify a larger payment —) to turn over to the lessor the net amount earned by the leased road during operation; that where there are no net earnings and the leased road has been operated by a receiver at an actual loss, as in the case before the court, the lessor, not the lessee, must bear that loss.

Whether the estate of the lessor could be charged with the loss to the displacement of mortgage liens, the Court said was not before it, but it intimated that it agreed with the special master who had held that the lessor could.

Illustrations of the special equities which might require the payment by the receiver of a reasonable rental regardless of the fact that the leased property did not actually earn it are a depot or terminal earning nothing but useful to the system, and "feeders" and connecting lines, not themselves earning large amounts, but furnishing valuable business to the lessee.

The court said that if the lessor does not acquiesce in the court operating its railroad, "if it knock at the door of the court and demand back its property," it is in a position to demand the rental stipulated in the lease.¹ This holding is in accordance with a decision of Judge Jenkins in the Northern Pacific case²

¹ Any important demand made upon a receiver not only should be carefully considered by the receiver but should be communicated by him to all parties in interest in order that whether the demand is granted or refused action may be taken only after they have had an opportunity to consider the consequences. In one case where the receiver did not pay the installments of the purchase price of rolling stock under a car trust agreement but kept possession of it notwithstanding occasional not too emphatic demands for its surrender, when the decree of sale was entered, it directed that the entire proceeds of the sale of the railroad should be applied if necessary to pay the amount due for the cars — and nothing but the appearance of a totally unexpected bidder at the sale saved the bondholders from seeing, as the result of three years operation by the court, their entire railroad go to pay for the rental of rolling stock.

² *Farmers' Loan & Trust Company v. Northern Pacific R. Co.*, 58 Fed., 257; 1893.

and with the language of the Supreme Court in the Wabash case.¹

Of course if the receiver adopts the lease he must pay rent as fixed by the lease.

Sometimes the fall of the lessee brings down the lessor. It needs a receiver as much as the lessee. As the court has possession of its property, a general creditor, whether a citizen of the same state as the lessor or not, may file his bill in the courts where the suits against the lessee are pending and obtain an order appointing receivers of the property of the lessor. A simpler method was used in the New York street railway litigation. The lessor, the Metropolitan Street Railway Company, filed a petition in the creditor's suit pending in the United States Circuit Court against its lessee, the New York City Railway Company, in which it asked to be made a party to that suit and to have the receivership extended so as to embrace all its interest in the property of which the receivers of the City Company had taken possession. It alleged that its affairs were inextricably tied up with those of the City Company, as all of its property was leased to that company; it had payments falling due on mortgages and leases; and it was dependent on the City Company for money with which to make the payments. The court made the order prayed for. Its action was attacked in the state courts and in the United States Supreme Court. A justice of the state court held it absolutely void, and appointed state court receivers.² The Supreme Court of the United States sustained the order of the circuit court.³

I now come to the foreclosure suit.

The federal courts having the property of the railroad company in their possession through their officers, it is withdrawn

¹ *Quincy M. & P. Co. v. Humphreys*, 145 U. S., 82, 101; 1892.

² *People v. Hasbrouck (Metropolitan St. Railway Company)*, 57 Misc., 130, 133-6; 1907.

³ *Re Metropolitan Street Railway Receivership*, 208 U. S., 90; 1908.

from the jurisdiction of all other courts and they have as ancillary to the suits in which the possession was acquired jurisdiction to hear and determine all questions respecting the title, the possession or the control of the property, although in the ancillary proceedings there is no diversity of citizenship.¹

Under this principle the trustee of any mortgage of the railroad company by the terms of which the right to begin a foreclosure suit has arisen, has his remedy in the courts where the creditors' suits are pending and the mortgaged property is situated.

Ordinarily the question of whether that right has arisen is beyond controversy. Upon default in payment there is a right to foreclose for the amount due, whether principal or interest.² Restrictive provisions are strictly construed and will not be held to restrict the right to foreclose if there is any other right such as a right to enter³ or a right to sell under a power of sale⁴ to which they may have been intended to apply. "A mortgage is a security for a debt and failure to pay the debt in whole or in part when it is due is necessarily a breach." A breach gives a right to enforce the mortgage and nothing but perfectly clear language can limit this right. The case from which I have just quoted, *Mercantile Trust Company v. Chicago P. & St. L. Railroad Company*, 61 Fed. 372, 1893, has always been an authority upon which counsel have relied when defending the right, immediately upon default in payment of interest, to foreclose mortgages which contain language seemingly, on a first reading at

¹ *Wabash Railroad v. Adelbert College*, 208 U. S., 38, at p. 54; 1908. As to whether actual possession as distinguished from priority in beginning suit or in moving for the appointment of a receiver is essential to exclusive jurisdiction, see *Adams v. Mercantile Trust Co.*, 66 Fed. 617; 1895; C. C. A. 5th Circuit. *Knott v. Evening Post Co.*, 124 Fed. 342; 1903. *Appleton Water Works Co. v. Central Trust Co.*, 93 Fed., 286; 1899; C. C. A. 7th Circuit. *Farmers Loan & Trust Co. v. Lake Street Elevated R. R. Co.*, 177 U. S. 51; 1900. *Compton v. Jesup*, 68 Fed. 263, 283; 1895.

² *Howell v. Western R. R. Co.*, 94 U. S., 463; 1877. *Chicago & Vincennes Railroad Co. v. Fosdick*, 106 U. S., 47, 68; 1883.

³ *State Trust Co. v. Kansas City Railroad Co.*, 120 Fed., 398; 1903.

⁴ *Morgan's Company v. Texas Central Railway Co.*, 137 U. S., 171; 1890.

any rate, intended to postpone such right until the default has continued for six months or some other fixed period of time. As in *Central Trust Company v. Worcester Cycle Mfg. Co.*, 93 Fed., 712, 1899, it was held that a provision in a mortgage postponing the right to foreclose for default in payment of interest for six months is solely for the benefit of the mortgagor and if waived by it cannot be set up by anyone else; it may be of no importance in a "friendly" foreclosure suit whether the language of a mortgage amounts to such a provision or not; but where the relations of the trustee of the mortgage and the railroad company are hostile it may be of great importance. I shall therefore give a brief statement of what is held in the leading cases which discuss the question.

In *Morgan's Company v. Texas Central Railway Company*, 137 U. S., 171, 1890, the mortgage provided that in case the railway company should default in the payment of any of the principal or interest of the bonds and the default should continue sixty days after demand, the principal should immediately become due, and upon the request of the holders of seventy-five per cent of the bonds the trustee might and should take possession of the railway; and upon request of the holders of seventy-five per cent of the bonds it should be the duty of the trustee "to foreclose this mortgage . . . and sell the property . . . at public auction." The court held that this language applied solely to foreclosure and sale at public auction without the aid of the court and did not limit the power of the trustee to proceed in a suit to foreclose, especially in view of the fact that the mortgage contained a further clause that "nothing herein contained shall be held . . . to prevent . . . the foreclosure of this instrument, the appointment of a receiver, or any other act or proceeding appropriate in such cases, by any court of competent jurisdiction." In *Chicago & Vincennes Railroad Company v. Fosdick*, 106 U. S., 47, 1883, the mortgage provided, page 50, that if default should be made in the payment of interest on any of the bonds and the default should continue six months after demand,

and the principal of all the bonds should become immediately due, the trustee might so declare the same and notify the company thereof; and upon the written request of the holders of a majority of the bonds should proceed to collect principal and interest of all bonds outstanding by foreclosure and sale or otherwise. The court held, page 68, that inasmuch as by its terms the conveyance was declared to be for the purpose of securing the payment of interest as well as principal, and "by the fourth article, the mortgagor's right of possession terminates upon a default in the payment of interest as well as principal," the trustees on non-payment of interest might file a bill of foreclosure. "This right . . . follows from the nature of the security and arises upon its face unless restrained by its terms." The court did not consider that there was anything in the mortgage which operated as such restraint. But although the court said that suit to foreclose for non-payment of interest would lie upon default, it held it would not lie to foreclose for accelerated principal except upon the written request of the holders of a majority of the bonds, pages 77-8. In *Mercantile Trust Co. v. Chicago, P. & St. L. R. Co.*, 61 Fed., 372, 1893, the mortgage provided that if default should be made in the payment of interest and should continue for six months it should be the *duty* of the trustee to proceed at law or in equity to enforce the rights of the holders of the bonds upon a requisition of the holders of at least one-third in amount of the bonds. The court held that this clause did not deprive the trustee of the *right* to proceed immediately upon non-payment of interest without more waiting. The court laid stress upon the fact that the mortgage fixed the right of the mortgagor to continue in possession until default in breach of a condition and not until default and six months thereafter.

In *Central Trust Company v. Worcester Cycle Mfg. Co.*, 93 Fed., 712, 1899, article 2 of the mortgage provided that the mortgagor might remain in possession until six months after default; article 4 that in case default in payment of interest should con-

tinue for six months the trustee might enter; article 5 that in the same case the trustee might sell and dispose of the property; and article 6 that the provision in article 5 was cumulative to the ordinary remedy of foreclosure in the courts and that the trustee at the written request of the holders of a majority in value of the bonds "should, whenever entitled to do so by the terms thereof, institute proceedings to foreclose this mortgage." The court considered that these articles were intended to postpone a suit to foreclose even for interest until the expiration of the six months, particularly in view of a proviso to article 6 that "neither the trustee nor the . . . holders of the bonds . . . or any of them, shall sell the premises hereby mortgaged . . . or institute any . . . proceeding in law or equity for the foreclosure hereof . . . otherwise than in the manner herein provided."

In general, it may be said that the language of railroad mortgages in recent years is usually sufficient to prevent foreclosure even for interest until the expiration of the period of grace, while that of older mortgages is not.

A provision that the mortgaged premises shall not be sold under proceedings at law or equity, "it being the intention . . . of the parties that the mode of sale by the trustee prescribed in the mortgage shall be exclusive," is void on the ground that it is an attempt to oust the jurisdiction of the court.¹

Before beginning a suit to foreclose, the trustee of the mortgage should see that every preliminary condition is complied with and should try to have evidence of such compliance which will be satisfactory even if the occasion for its use may not arise for years. So far as possible, written admissions of demands, notices and requests should be obtained, and where anything is done written admission of which cannot be obtained, the doing of it should be witnessed by several people to cover contingencies of death, disappearance and so on. The trustee

¹ *Guaranty Trust Co. v. Greene Cove Co.*, 139 U. S., 137, 142; 1891.

should not confine itself to doing only such things as it thinks are necessary to establish its right to foreclose. It should do whatever anyone whose interest it might be to delay the foreclosure could possibly think of saying ought to have been done, provided, of course, it can be done without prejudice to the rights of the trustee. On the day the interest is due and on the expiration of the days of grace,¹ if any, several bondholders should demand payment, presenting the coupons at the place where the interest, by the terms of the bond, is payable, and, as an additional precaution, at the place where the last coupon was paid, at the office of the company, and at the office of the receiver, if there is one. The bondholders should make affidavits to the fact of the presentation, demand and non-payment and should deliver the affidavits with the coupons attached to the trustee to hold.

Where the mortgage provides that if a default in payment of interest continues for six months the trustee shall upon the demand of the holders of a majority in amount of the bonds declare the principal due and begin suit to foreclose, a demand in the language of the mortgage should be signed by the necessary bondholders; they should place opposite their signatures the amount and numbers of the bonds held by them and should exhibit the bonds to the trustee if so required. Such demands are usually made by a committee of bondholders who have in their own possession or that of a depositary acting for them more than a majority in amount of the bonds. The committee passes a resolution authorizing the secretary to make the demand on its behalf and the secretary delivers to the trustee a certified copy of the resolution which is usually signed also by the members of the committee. The secretary also certifies to

¹ In *Alabama & G. Mfg. Co. v. Robinson*, 56 Fed., 690, 1893, C. C. A., 5th Circuit, the court declined to pass on the question of whether the coupons were or were not entitled to days of grace, but said that even if they were, where the bonds provided that the principal should become due if default in interest should continue for six months after maturity and demand of payment, the six months was not in addition to days of grace but ran from the day of payment named in the coupon.

the trustee the number of bonds which the committee has in its possession. The trustee then notifies the mortgagor that in accordance with the request of the majority of the bondholders it declares the principal of the bonds due.

If the mortgage provides that upon default in payment of interest continuing for a specified time the principal shall become due, the trustee at the expiration of the time may foreclose for principal and interest without a formal declaration of the maturity of the principal.¹ It has been held that if an option to declare the principal due is to be exercised it should be done promptly.²

Acceptance of the interest before the principal becomes due is a waiver of the default; acceptance of the interest after the principal has become due has also been held to be a waiver.³

Let us assume that the trustee of the mortgage is satisfied that it has a right to foreclose and goes ahead. What does it do?

It presents a petition, entitled in the creditor's suit, to the court of primary jurisdiction praying to be allowed to bring suit to foreclose its lien. Usually the prayer of the petition is granted as a matter of course.⁴ The bill which has been presented to the court with the petition is immediately filed.

¹ *Morgan's Co. v. Texas Central Railway Co.*, 137 U. S., 171; 1890.

² *Wilson v. Winter*, 6 Fed., 16; 1881.

³ *Alabama & G. Manufacturing Co. v. Robinson*, 56 Fed. 690; 1893; C. C. A., 5th Circuit.

⁴ But not always. In the pending creditor's suit for the administration of the assets of the Chicago, Rock Island & Pacific Railway Company, a petition by the holders of bonds issued under the Refunding Mortgage (the trustee having refused to act) for leave to file a bill praying among other things for a foreclosure of the mortgage, was presented to the court on March 21, 1916. The following day the court set it down for hearing on April 24, 1916. The hearing took place before Judge Geiger on May 24, 1916. Counsel for the railroad company in opposition to the application argued that the court had the right to deny the application where the bill clearly stated no case, and that even if the bill stated a case or it was doubtful whether it did or not, the court was not bound to permit an independent suit to be brought or an ancillary or independent bill to be filed, but might only permit an intervention *pro interesse*

110 FORECLOSURE OF RAILROAD MORTGAGES

It was usual formerly to begin the bill with the statement that the complainant files "this its dependent bill." Sometimes the foreclosure bill and other papers in the foreclosure suit were entitled both in the creditor's suit and the foreclosure suit. Anything of the sort is unnecessary. The suit is an ordinary suit to foreclose a mortgage. From the time the court enters the order permitting the bill to be filed "the court proceeds in it," as Judge Taft said in the passage already quoted, *supra*, page 83: "without further regard to the pleading or course of the principal action." Any proper party may be joined as a party defendant regardless of whether he is a party to the creditor's bill or not.

The trustee has the right to bring the suit without joining any bondholders as parties complainant or defendant. The same parties should be made defendants as in any foreclosure suit, the mortgagor, its grantees, subsequent mortgagees, lienors and so on. It is usual to join the receivers in the creditor's bill as parties defendant, but it is unnecessary and has been held to be improper.¹

The foreclosure bill sets out :

- (a) diversity of citizenship where it exists;

an unnecessary fact stated on the principle of pleading all the grounds of jurisdiction there are :

- (b) the making of the mortgage, the execution of the bonds secured by it, the certification of them by the trustee, the issuing of them in

suo; citing *Wiswell v. Sampson*, 14 How. (U. S.), 52, 65, 67, 1853. *Compton v. Jesup*, 68 Fed., 263, 279; 1895.

Counsel for the petitioners contended that the bill stated a cause of action, and that consequently the petitioners had an absolute right to file the bill; citing *Minot v. Masten*, 95 Fed., 734; 1899. *United States Trust Co. v. Chicago Terminal Co.*, 188 Fed., 292; 1911. *Western Union Company v. United States & Mex. Trust Co.*, 221 Fed., 545; 1915. *Odell v. Batterman Co.*, 223 Fed., 292; 1915. Neither counsel cited any case where it had been held that the court was bound to allow a mortgagee to proceed by bill rather than by intervention *pro interesse suo*; nor on the other hand any unreversed case where the court had refused to allow the mortgagee to proceed either by bill or intervention.

Judge Geiger granted the prayer of the petition August 14, 1916.

¹ *Continental Trust Co. v. Toledo, St. L. & K. C. R. Co.*, 82 Fed., 642; 1897.

accordance with the terms of the mortgage, and the ownership of them by purchasers for value;

(c) a description of the property mortgaged;

(d) a statement of any liens the holders of which are made parties defendant and if any of the liens are prior to the mortgage the reasons that justify the complainant in making parties the holders of such liens;

(e) a statement of the default;

(f) provisions of the mortgage that upon default the income is assigned to the mortgagee or the trustee is entitled to the appointment of a receiver to operate the railroad and receive the income; the insolvency of the defendant and the inadequacy of the mortgaged property as security;

(g) the possession of the mortgaged property by the court under the creditor's bill;

(h) the fact that the matter in controversy exceeds exclusive of interest and costs, the sum or value of three thousand dollars:

a fact alleged on the same principle as (a).¹

If the principal has become due by acceleration or otherwise the bill so states, and prays that the mortgage be foreclosed unless the whole amount due for principal and interest is paid.

If the default is non-payment of interest only, the prayer is that the mortgage be foreclosed unless the interest is paid. It would seem, however, in view of what has been said in the Supreme Court and acted upon in lower courts, that it might be well for the bill to pray also that, in case the overdue interest should be paid, the court should retain jurisdiction in order to sell the property in case of another default in payment of interest or principal.² If the principal becomes due before judgment a supplemental bill is filed setting up the fact and enlarging the prayer.

The bill in addition to praying for a foreclosure and sale

¹ Of course where the mortgaged property is not in the possession of the Court allegation (g) is omitted and allegations (a) and (h) are essential.

² *Howell v. Western Railroad Co.*, 94 U. S., 463, 466; 1877. *Chicago & Vincennes R. R. Co. v. Fosdick*, 106 U. S., 47 at 68 and 69; 1883. In *Toler v. East Tennessee, V. & G. Ry. Co.*, 67 Fed., 168, 1894, at 181, the court said: "The debtor can prevent a sale by paying into the master's office the amount necessary to pay the interest in default. All proceedings will then be stayed until another default."

112 FORECLOSURE OF RAILROAD MORTGAGES

asks that a receiver pending the suit be appointed, and that the trustee have judgment against the company for the amount of the bonds, or, if there is no provision in the mortgage authorizing such a judgment, that the bondholders have judgment for any deficiencies.

The railroad company seldom files an answer at once. It usually appears and consents to an order that the receivership under the creditor's bill be extended to the foreclosure suit and that the receivers under the creditor's bill be appointed receivers under the foreclosure bill; but without the appearance or consent of the railroad company the court will make the order where the property is in the hands of receivers and there is a default under the mortgage. The order contains generally the same provisions as the order appointing receivers under the creditor's bill, such as provisions authorizing them to operate the property, to pay preferred claims and to bring and defend suits. It sometimes contains provisions that all liabilities of the receivers incurred while operating under the creditor's bill shall be liabilities of the receivers under the foreclosure bill. In the New York City Railway receivership it was announced more than once by Judge Lacombe that the court would hold all the property over which it had appointed receivers liable to the last penny for the indebtedness of the receivers whether incurred in operating the properties as receivers under the creditor's bill or under the foreclosure bills and whether incurred as receivers of the lessee New York City Railway Company or the lessor Metropolitan Street Railway Company; as between the lessee and the lessor, the deficit which arose from expenditures for permanent improvements upon the property of the lessor made before it had been taken over by separate receivers, was charged on the settlement of accounts to the lessor; and the court intimated — although it considered that on the facts before it it did not have to decide the question — that the lien of the mortgagees of the lessor would be displaced, if necessary, in favor of the claim of the receivers of the

lessee to be repaid such expenditures.¹ There are cases which say that indebtedness for permanent improvements made upon the mortgaged property during a receivership under a judgment creditor's bill ought not to be paid out of the mortgaged property or even out of the income earned after the receivership has been extended to the foreclosure suit.

"The reconstruction, enlargement, or permanent improvement of mortgaged property by a court's receiver, under such circumstances does not any more displace or postpone the prior mortgage lien than would the like act of the mortgagor in the absence of a receivership."²

The court relied upon *Kneeland v. American Loan Company*, 136 U. S., 89, 1890, where a claim for so-called rental of rolling stock under a car trust agreement against a receiver appointed at the instance of a judgment creditor of a railroad company was sought to be enforced against the receiver in the foreclosure suit as a lien upon the property in priority to the mortgage. The court held that the claim could not be given such a preference and that too, although the mortgagees were parties defendant to the creditor's bill. But the court clearly did not consider the claim a debt of the receivership at all (see page 99). It said that there were two lien holders one with a lien on the railroad and the other with a lien on the cars and neither could claim to be paid out of the properties of the other. On the general question of the liability of the receiver in a foreclosure suit for the indebtedness of the receiver under the creditor's bill, the court laid down this principle:

"A court which appoints a receiver acquires, by virtue of that appointment, certain rights and assumes certain obligations, and the expenses which the court creates in discharge of those obligations are burdens necessarily on the property taken possession of, and this irrespective of the question who may be the ultimate owner, or who may have the preferred lien, or who may invoke the receivership. So if, at

¹ *Pennsylvania Steel Co. v. New York City Ry. Co.*, 198 Fed., 721, 734; 1912; C. C. A., 2d Circuit.

² *Atlantic Trust Co. v. Dana*, 128 Fed., 209, 230; 1903; C. C. A., 8th Circuit.

the instance of any party rightfully entitled thereto, a court should appoint a receiver of property, the same being railroad property, and therefore under an obligation to the public of continued operation, it, in the administration of such receivership, might rightfully contract debts necessary for the operation of the road, either for labor, supplies or rentals, and make such expenses a prior lien on the property itself."

To say that the court meant that only debts contracted by it for operation as distinguished from debts for construction are to be paid out of the property, is to disregard what the court lays stress on, "the obligation to the public of continued operation," and the fact that to the performance of this obligation new construction is often as essential as supplies. Suppose after a receiver is appointed under a creditor's bill, the court finds it is dangerous to operate trains unless a portion of the railroad is entirely reconstructed. In endeavoring to fulfill "the obligation to the public of continued operation" the court orders the receiver to make a contract for such reconstruction. It knows that no contractor would undertake any such work with the understanding that the only fund to pay him would be the earnings of the receivership under the creditor's bill, and that such receivership might be superseded at any moment. Surely nothing can be more unfortunate than to allow the contractor to perform his contract with the court and then when he has performed it, to say to him that the court refuses to pay him, although it has property in its hands worth millions of dollars, because other parties have come into the litigation since the work was undertaken.

What effect upon the rights of the bondholders and the general creditors follows from the extension of the receivership to the foreclosure suit? ¹

¹ When a suit to foreclose is begun, pending a creditor's suit, the order directs sometimes that the receivership be extended to the foreclosure suit; sometimes that the receivers already appointed be appointed receivers of the property covered by the mortgage; very often the order contains both directions. By "extension of the receivership," I mean the making of any of these orders.

To whom do the net earnings of the receivership belong so long as the receivership is simply under the creditor's bill? The question is seldom one of practical importance, because such a receivership is usually so brief that the net earnings all go to the payment of preferred debts, laborers' wages, traffic balances and so on. I think lawyers generally have been under the impression that any net earnings not so used were distributable *pro rata* to all creditors secured or unsecured, particularly where the mortgage did not purport to assign the income to the mortgagee; the reason for this impression being the statement so often made, for instance in *United States Trust Company v. Wabash*, 150 U. S., 287, 1893, at page 308, that "until the mortgagee asserts his rights under the mortgage to the possession of the road by filing a bill of foreclosure, or, if the road be in the hands of a third party, by demanding possession of such party, he has no right to its earnings and profits." Judge Sanborn so held in *Farmers' Loan & Trust Co. v. American Waterworks Co.*, 107 Fed., 23, 1895, saying that the income earned by receivers appointed at the suits of stockholders and creditors prior to the beginning of the foreclosure suit was free from any equitable lien of the mortgage bondholders; that it required a demand of surrender of the income and profits or the filing of a bill of foreclosure to charge this income with the superior lien of the mortgage and that the income earned by receivers prior to the foreclosure bill was applicable to the payment of the unsecured as well as the secured debts; but Judge Taft held in *Thomas v. Cincinnati, N. O. & T. P. Ry. Co.*, 91 Fed., 202, 1898, that the net earnings from the operation of the railroad property by a receiver under a general creditor's bill belonged to the creditors in the same order of priority as the proceeds of the sale of the property itself, and the court of appeals for the third circuit held in *Haehnlen v. Drayton*, 192 Fed., 300, 1911, that the net earnings in the period between the filing of a bill, which though filed by a judgment creditor the court considered clearly a general creditor's bill, and the beginning of a foreclosure suit

belonged to the bondholders. Where the creditor's bill is brought by a judgment creditor for his own benefit the net earnings go to him until a mortgagee takes steps to impound them.¹ From the moment the receivership is extended to the foreclosure suit, the net earnings belong to the bondholders secured by the mortgage whether the mortgage assigns income or not.²

Even though the mortgage by its terms covers earnings, they do not pass to the mortgagee until he makes demand for the mortgaged property or for surrender of its possession under the provisions of the mortgage.³ The usual way of securing the earnings for the bondholders is by the appointment of a receiver in the foreclosure suit; but a demand for possession made by the commencement of a suit by a mortgagee to be put in possession,⁴ or the filing by the mortgagee of an intervening petition in a pending receivership claiming the income,⁵ is sufficient to get for the mortgagee all income thereafter earned.

At the time the order is made extending the receivership of the general creditor's bill to the foreclosure suit, it is usual to make an order consolidating the two suits. Such litigations used to go on after the order of consolidation without any one connected with them having any definite idea — unless perhaps an erroneous one — of what difference it made whether the suits had been consolidated or not, except that pleadings and orders were entitled in both suits, until the question was discussed in opinions by Judges Taft and Lurton in the receivership of the Toledo, St. Louis and Kansas City Railroad Company.⁶ They

¹ *Sage v. Memphis & Little Rock R. R. Co.*, 125 U. S., 361; 1888.

² *Central Trust Company of New York v. Chattanooga R. & C. R. Co.*, 94 Fed., 275, 281, 1899, and *Freedman's Saving Company v. Shepherd*, 127 U. S., 494, 502; 1888.

³ *Galveston Railroad Company v. Cowdrey*, 11 Wall., 459; 1871.

⁴ *Dow v. Memphis & L. R. Co.*, 124 U. S., 652; 1888.

⁵ *Atlantic Trust Co. v. Dana*, 128 Fed., 209, 219; 1903.

⁶ *Continental Trust Co. v. Toledo, St. L. & K. C. R. Co.*, 82 Fed. 642, 645-6-7; 1897. 95 Fed. 497, 505-6; 1899; C. C. A., 6th Circuit.

said that each suit is after consolidation an independent suit; consolidation does not change the rules of equity pleading nor the rights of the parties; the parties in one suit do not become parties in the other and a decree in one suit is not a decree in the other unless so directed; the bringing on of the two suits for hearing does not avoid the necessity of separate decrees in each case; nor does the fact that the two suits have been consolidated require that every issue under each suit should be heard at the same time. A statement sometimes made that Judge Taft held, where a creditor's suit and a foreclosure suit are consolidated, any creditor may defend against the bill to foreclose, is not correct. What he did hold was that every creditor has the right in the creditor's suit to attack the claim of every other creditor who files a claim in that suit; and consequently as a committee had presented the claim of the bondholders in that suit the bonds could be attacked like any other claim — a holding which shows the advisability of bondholders keeping out of the creditor's suit unless there is something substantial to be gained by getting in.

I shall now consider the subjects of preferred claims and interventions.

Certain classes of indebtedness incurred by the railroad company before the receivership are entitled to payment in priority to bonds and other debts out of the income of the receivership and sometimes out of the body of the property, mortgaged or unmortgaged, of the railroad company. Indebtednesses of this sort are called "preferred claims" and are described in the cases as "current debts," "debts for current expenses," "debts of income," "debts of operation" or "supply claims."

Before considering the extent to which current debts are entitled to priority, whether out of income or *corpus*, I shall give the definition of a current debt in the words of the Supreme Court: a "debt not contracted upon the personal credit of the

company but to keep the railroad itself in condition to be used with reasonable safety for the transportation of persons and property, and with the expectation of the parties that it is to be met out of the current receipts of the company.”¹

In order to bring his claim within this definition a claimant need not prove that anything was said by him or the railroad company about their expectations or the sort of credit he was contracting upon. The question of whether the creditor contracted upon the personal credit of the railroad company, or on the contrary with the expectation that he was to be paid out of current receipts, is to be determined “in each case by the amount of the debt, the time and terms of payment and all other circumstances attending the transaction.” Two decisions of the Supreme Court, handed down on the same day, one, *Southern Railway v. Carnegie Steel Company*, 176 U. S., 257, 1900, holding that an indebtedness for rails sold in certain circumstances was a preferred debt, and the other, *Lackawanna Iron & Coal Company v. Farmers’ Loan & Trust Company*, 176 U. S., 298, 1900, holding that an indebtedness for rails sold in other circumstances was not, are helpful to an understanding of what a current debt is. In the Carnegie Company case the court said that in view of the comparatively small amount of rails there was nothing to suggest “that they were to be used in constructing new and additional road and not to keep existing roads in proper condition for use. Every railroad must have on hand a limited quantity of rails in order to keep every part of its line in proper and safe condition.” In the Lackawanna Company case the court said that “the work required to be done in order to put the main road . . . and its divisions in proper condition was not such as would be done in the ordinary course of the business and operation of a railroad, but was so extensive as to amount to reconstruction or the construction of new road,” and therefore, although the “rails were imperatively required in order that the road might be safely used for transportation of

¹ *Southern Railway v. Carnegie Steel Company*, 176 U. S., 257, 285; 1900.

persons and property," the claimant was not entitled to a preference even out of the income of the receivership. These two cases have been generally treated by the courts as authority, notwithstanding qualifying statements in both, for the broad propositions, that where supplies or work are for repairs, maintenance, to keep the road up, the indebtedness is a current debt; where they are for construction, whether original construction or reconstruction, the indebtedness is not a current debt.

The Supreme Court has often said that the priority of unsecured claims "is recognized only in a few specific cases" and that "it is the exception, not the rule that the priority of mortgage liens can be displaced"; but, as a matter of fact, in the ordinary receivership of a railroad, the majority of the unsecured claims are given priority. The principal claims that are not are indebtednesses for money lent, for land, equipment, — except perhaps such as may be necessary to keep the road a going concern,¹ — new construction, rent, guaranties on bonds or stocks of other railroads and tort claims.²

In *Fosdick v. Schall*, 99 U. S., 235, 1878, the court laid down these rules:

(1) When a railroad mortgagee asks a court of chancery to appoint a receiver of railroad property pending foreclosure proceedings the mortgagee is asking for a favor and not a right; and therefore the court may provide, as a condition upon which the appointment is made, that outstanding debts for labor, supplies, equipment or permanent improvements of the mortgaged property shall be paid out of the income earned during the receivership (p. 253).

(2) If no such provision is made when the receiver is appointed, and it appears in the progress of the case that earnings which ought to have been employed to pay debts for labor, supplies and the like had been used to pay bonded interest or to provide additional equipment or

¹ *Rhode Island Locomotive Works v. Continental Trust Co.*, 108 Fed., 5, 7; 1900; C. C. A., 6th Circuit.

² *Penn. Steel Co. v. N. Y. City Ry. Co.*, 216 Fed., 458, 472; 1914; C. C. A., 2d Circuit. *St. Louis Trust Co. v. Riley*, 70 Fed. 32; 1895; C. C. A., 8th Circuit.

permanent improvements, the court has power to use the income of the receivership to pay debts which but for the diversion of the income would have been paid in the ordinary course of business (p. 253).

(3) If income of the receivership which would otherwise be applied to the payment of debts for current expenses, *i.e.* under the provisions of rules (1) and (2), is used during the receivership to make permanent improvements, to the extent to which this is done the proceeds of the sale of the mortgaged property may be used to pay off such debts. "The same may sometimes be true in respect to expenditures before the receivership" (p. 254).

The theory upon which the court based these rules was that daily and monthly earnings ordinarily should go to pay daily and monthly expenses; and when these earnings are used to pay bonded interest or make permanent improvements for the betterment of the mortgaged property, they are diverted from those to whom in equity they belong to the benefit of the mortgage creditors.

It will be noted that these rules did not authorize the court to apply the earnings of the receivership to current debts unless

- (a) the order was made as a condition to the appointment of a receiver, or
- (b) there was a diversion before the receivership of current earnings from the payment of current debts to the benefit of the bondholders.

These limitations were removed in *Burnham v. Bowen*, 111 U. S., 776, 1884. In that case, a foreclosure suit, no provision was made in the order appointing the receiver for the payment of current debts; and there was no proof of any diversion by the company of current earnings. The court nevertheless held that current debts were a charge on the income earned during the receivership, saying that when, in enforcing the rights of mortgage creditors, a court of chancery took possession of a mortgaged railroad, it ought to do what the company would have been bound to do if it had remained in possession, namely, pay out of what the court receives from earnings all the debts which in equity and good conscience are chargeable

upon such earnings; "debts of the income should be paid from the income before it is applied in any way to the use of the mortgagees."

Rule 2 of *Fosdick v. Schall* as modified by the holding in *Burnham v. Bowen* therefore may be stated thus: the court has power at any time to use the income of the receivership to pay current debts of the railroad company.

Upon the theory which underlies Rule 1 in *Fosdick v. Schall*, some judges considered it proper to make it a condition of the order appointing a receiver of a railroad that substantially all unsecured debts should be paid preferentially out of the income of the receivership or even out of the mortgaged property. This practice was condemned in *Kneeland v. American Loan Company*, 136 U. S., 89, 1890, the court saying (see page 97), "when a court appoints a receiver of railroad property it has no right to make that receivership conditional on the payment of other than those few unsecured claims which, by the rulings of this court, have been declared to have an equitable priority."

The effect of this decision was to take from the court the right to give any preference in an order appointing a receiver which it had not the right to give at any time during the receivership.

Rule 3 of *Fosdick v. Schall* has been carried to its fullest extent. The diversion which entitles the holder of a current debt to a preference out of the *corpus* may be diversion of the income of the receivership or of the company for a limited period before receivers were appointed;¹ and under *Southern Railway v. Carnegie Steel Company*, 176 U. S., 257, 1900, the term diversion covers not only income spent for permanent improvements, but for the payment of charges upon the mortgaged property and for other purposes beneficial to the mortgagee.

¹ *Virginia & Alabama Coal Co. v. Central R. & B. Co.*, 170 U. S. 365; 1898. *International Trust Co. v. Townsend Co.*, 95 Fed. 850; 1899. *Rhode Island Locomotive Works v. Continental Trust Co.*, 108 Fed. 5; 1900.

122 FORECLOSURE OF RAILROAD MORTGAGES

In that case the court held that payment of interest on underlying bonds and bonds of lessor roads was a diversion, although in *St. Louis, etc., R. R. Co. v. Cleveland, etc., R. Co.*, 125 U. S., 658, 1888, it had held that payment of interest on a prior mortgage was not.

Some current debts are entitled to a preference out of the *corpus*, although there has been no diversion of income.

In *Gregg v. Metropolitan Trust Co.*, 197 U. S., 183, 1905, the Court refused such a preference to a claim for cross ties essential to the replacement of ties decayed in current operation of the railroad, saying that claims for supplies essential to the preservation of the road were not entitled to such a preference, but only claims the payment of which was "necessary to the business of the road." As instances of these the court referred to the claims which were given a preference out of the *corpus* in *Miltenberger v. Logansport Ry. Co.*, 106 U. S., 286, 1882: debts to connecting lines of road for materials, repairs, and unpaid ticket and freight balances, and debts to operatives for wages. In that case, the court said that, unless wages were paid, the operatives might stop work to the injury both of the property and of the public; and if the amounts due to connecting railroads were not paid, they might refuse to continue business relations with the insolvent railroad company and its receiver.

Three judges dissented in the Gregg case, saying that the correct test of the right to priority out of the *corpus* is whether or not the indebtedness is for something essential to keep the railroad in operation; "that as the road from its nature and public responsibilities must be kept a going concern, whatever is furnished for that purpose must be paid regardless of whether there is income or whether there has been diversion of income."

The rules as followed by the courts to-day may be stated thus:

1. — Any current debt is entitled to a preference

(a) out of the income of the receivership, regardless of whether there is any diversion of income before or after the receivership, and

(b) out of the *corpus* of the mortgaged property to the extent that there has been diversion of income during the receivership or for a limited time before the receivership.

2. — A current debt the payment of which is necessary to the business of the road is entitled to a preference out of the *corpus* of the property whether or not there has been diversion of income at any time before or during the receivership.

The preference to which the holder of a current debt may be entitled is not confined to the property of the company with which the creditor contracted. Thus if the lessee of the property of a company buys supplies to be used upon the property of the lessor company, the creditor is entitled to priority of payment out of income or *corpus*, as the case may be, of the lessor company.¹

In one case² it has been held that claims of current creditors are to be preferred only over mortgage creditors and not over general creditors. In the New York City Railway litigation the master, the circuit judge and the circuit court of appeals declined to follow this ruling. There was no mortgage by the City Company and the receiver of the City Company had in his hands a large amount of assets on which there were no liens, unless a lien attached for current debts. The question was whether the holders of current debts were entitled to any preference, and if so, to what extent. Judge Lacombe held, and his ruling was affirmed by the Circuit Court of Appeals, that current debts were entitled to preferred payment over general debts, and out of any assets whether *corpus* or income, as in his opinion it is only where a creditor is asking to displace a lien that it is necessary to go into the question of diversion of income.³

¹ *Virginia and Alabama Coal Company v. Central Railroad Company*, 170 U. S., 355; 1898.

² *Whelan v. Enterprise Transportation Company*, 175 Fed., 212, 1909.

³ *Pennsylvania Steel Company v. New York City Railway Company*, 208 Fed., 168, 182-3, 1913; aff. 216 Fed., 458, 471, 1914.

Preferred claims are often spoken of as six months' claims. Mr. Justice Holmes uses this term in *Gregg v. Metropolitan Trust Company*. Under the decisions, however, all the meaning that can be given to those words is that the claim must not be very old. In *Southern Railway v. Carnegie Steel Company*, 176 U. S., 257, 1900, the court said that while a rule limiting the claims to those accruing within six months did justice in most cases, there was no absolute rule on the subject and older claims might under the circumstances of particular cases be included among preferred claims.

In the *Carnegie Steel Company* case it appears, page 272, that interest was allowed upon the entire claim by the lower courts and the order appealed from was affirmed by the United States Supreme Court. This was followed in *Penn. Steel Co. v. N. Y. City Ry. Co.*, 216 Fed., 458, 471; 1914. The court discussed *Thomas v. Railroad Company*, 149 U. S., 95, 1893, which has often been supposed — and justly — to hold that interest on all claims ceased from the time of the appointment of a receiver; and said that that ruling did not apply where the fund was large enough to pay principal and interest of all claims of any given class entitled to a preference out of the fund. This principle, the court said, was settled by *American Iron Company v. Seaboard Air Line Railway Company*, 233 U. S., 261; 1914.

The principles which govern the right to intervene in a foreclosure suit are simple and easily applied. But one who approaches the subject for the first time may easily be confused or even misled by general statements in the cases and textbooks which are true only as to some kinds of interventions and are untrue as to other kinds. An inference may be drawn from such statements that permission to intervene is difficult to get; that the consent of the plaintiff is in general a prerequisite; and that the cases are in hopeless confusion as to the right to intervene of one with a paramount title — by which I mean a right antagonistic or superior to that of one or both of the

parties; — but nothing can be more erroneous. In practice a petition to intervene, if it makes anything of a case, is nearly always granted; the consent of a plaintiff is seldom a prerequisite; and the right to intervene *pro interesse suo* is granted to a petitioner asserting a paramount title almost as a matter of course.

A few illustrations may make clear the different sorts of interventions that are usual in foreclosure suits and the different principles applicable to them.

1. A company mortgages its railroad to a trustee for bondholders subject to all rights and equities which exist in favor of A against the company. Upon default the trustee brings suit to foreclose the mortgage making the railroad company the sole defendant. A petitions to be allowed to intervene and become a party defendant, in order that the question of what his rights are may be adjudged and the decree may direct that the entire property of the railroad be sold subject to his rights as adjudged by the decree; or that it be sold free and clear of all those rights, a certain amount of the purchase price to go to A. The position the trustee takes upon such a petition depends on whether he thinks it more important to get the best possible price at the sale or to get a speedy decree. The trustee may say: "The railroad will bring a better price if the purchaser knows exactly what he is getting, either a property free from all incumbrances or with an incumbrance in favor of A, the exact limits of which the decree defines; such a decree can only be made if the prayer of the petition be granted and therefore I consent that A be made a party defendant." Upon that consent the court will always allow A to intervene and become a party defendant. On the other hand, the trustee may say: "I am in a great hurry to get a decree; the bondholders expect to buy in the railroad at foreclosure sale and reorganize the property; they have agreed on a plan or reorganization and bankers are ready to take bonds of the reorganized company; to try out the question of what the rights of A are, or whether he has any, may

take a year or more, and by the time the matter is decided, times may be bad and the reorganization impossible; the bondholders are quite ready to take the title subject to the rights of A; and he should be left to fight out later with the reorganized company what those rights are." On this statement the court might very well say to the petitioner: "As long as the complainant objects, I ought not to delay him in getting the sort of a decree he is willing to take; you are not deprived of any rights by not being allowed to become a party defendant, and, although I would make the order you ask if the plaintiff were willing, in the face of his opposition I must deny your petition." That is the sort of case the court was referring to in *French v. Gapen*, 105 U. S., 509, 1881, when it said at page 525:

"But while the petitioners were not in fact parties, they might with propriety have been made such, and there cannot be a doubt that if they had intervened before the decree of sale, and asked to be made defendants, it would have been within the power of the court, *with the consent of the complainants* to take them in."

But suppose A says to the court: "I am in a hurry too. I ought not to be compelled to wait till this litigation is over, but the order of the court does compel me to wait. For this court has exclusive jurisdiction over the railroad and you refuse to let me enforce my rights against it here by denying my petition to be allowed to intervene and become a party defendant."

The court would answer: "Not at all. I deny you leave to intervene and become a party. I do not deny you permission to enforce your rights in this court. I give you permission now to intervene *pro interesse suo*. Under that sort of an intervention you do not become a party complainant or defendant to the main suit. You get no right to be heard on the issues involved in that suit. File a petition setting up the facts as to your rights. I will order any party to the suit who thinks he may be affected by your claim to move to dismiss your petition or answer within a limited time. If there is a motion to dismiss I will pass on the motion promptly myself. If there is an

answer, I will refer it to the master and you may bring on the master's report for a hearing as soon as you and the other side are ready."

So whether one may be permitted to intervene or not depends upon the sort of an intervention prayed for. An intervention of one with a paramount title for the purpose of becoming a party defendant is usually denied if the complainant objects; for the purpose of protecting one's interest — *pro interesse suo*, — is usually granted, regardless of whether complainant consents or opposes, unless it complicates the main suit and it is perfectly clear that the petitioner's rights can be completely protected in some other way. The principle is plain enough: a complainant ought not, without his consent, to be involved in controversies with a stranger which will delay the enforcement of his rights, nor ought he, by refusing his consent, to be able to delay the stranger in the enforcement of the stranger's rights.

In foreclosure suits the sort of intervention which the court refuses to allow if complainant objects is in practice not common. Where there is such a case the complainant is often quite as willing as the petitioner to have the prayer granted.

The intervention *pro interesse suo* is the most common of all.¹

A third kind of intervention is common also: someone who is represented by a party to the record — a bondholder by the trustees of the mortgage, a stockholder or a general creditor by the railroad company — asks to be allowed to intervene and become a party plaintiff or defendant, as the case may be. As he is already represented what facts must he show to succeed? Clearly, that his representative is not doing his duty or by reason of conflicting interests is not in a position to do his duty. About the principle governing these applications there is no

¹ The development of the petition *pro interesse suo* from the examination *pro interesse suo* and of the "dependent" bill from the petition *pro interesse suo* is traced in *Krippendorf v. Hyde*, 110 U. S. 276, 1884.

conflict. The only question is one of fact — is the representative, already a party to the suit, failing in the performance of his duty; is his position such that he must in all probability fail? If so, the applicant is allowed to intervene and become a party plaintiff or defendant; if not, the application is denied. Thus Judge Taft said: "The refusal of the board of directors to make a valid and equitable defense to the foreclosure of the mortgage and a sale of all of the franchises and property belonging to the road when the existence of such a defense is brought to their knowledge would of itself constitute such gross neglect or fraud on their part as to require the court to permit their interested *cestuis que trustent*, the stockholders, to make the defense themselves."¹ In a case² where one trust company was trustee under three different mortgages and brought one suit to foreclose all three, bondholders under the second and third mortgages were permitted to intervene as defendants; the court saying "it is manifestly impossible for the trustee to fairly represent both sides in the resulting controversies except by assuming such a position of neutrality as would seriously affect the force with which such conflicting interests are to be presented for the consideration of the court."

The court may allow a person claiming some or all of the property in its possession to proceed by an action at law or by intervening petition or in a proper case by bill. Where the court allows the claimants to proceed by intervention in the suit, if the intervention is based on a legal cause of action it may be submitted on proper issues to a jury. In such a case the verdict is advisory and may be disregarded by the court in whole or in part.³ The usual method, however, even where the claim is a legal one, of disposing of an intervention, is by reference to a master.

¹ *Farmers' Loan & Trust Co. v. Toledo, A. A. & N. M. Ry. Co.*, 67 Fed., 49; 1895.

² *Farmers' Loan & Trust Co. v. Northern Pacific R. Co.*, 70 Fed., 423; 1895.

³ *Kohn v. McNulta*, 147 U. S., 238; 1893. *Clyde v. Richmond & D. R. Co.*, 72 Fed. 121; 1896; C. C. A., 4th Circuit.

It is sometimes said that to proceed by intervention is more expeditious than by bill. This is probably so in matters of minor importance; but not so in a matter like the foreclosure of a mortgage covering a substantial part of a railroad. At any rate, the fact that trustees of mortgages always prefer to proceed by bill shows that this is their opinion. The reason in their mind is that everything is more clearly defined about a suit to foreclose than an intervention for that purpose. The parties to the foreclosure suit are those named in the bill and such others as the court makes parties by order; the parties to the creditor's bill are not from that fact parties to the foreclosure bill, even after an order is made consolidating the two suits. On the other hand, while it may be that the court has the right to confine the defense to a foreclosure by intervening petition to such parties as would be necessary parties to a bill, it is generally assumed that all parties to the main suit have a right to defend. Every party to the suit in which the intervening petition is filed is bound to take notice of every intervention.¹

In what cases, if any, does an appeal lie from an order denying or granting a motion to intervene?

In the federal courts "an appeal, as a general rule, lies only from a final decree."² But there may be many final decrees, for the purposes of appeal, in an equity suit. Every decree is a final decree which disposes finally of someone's claim. In *Central Trust Co. v. Grant Locomotive Works*, 135 U. S., 207, 1890, the Court gives several illustrations of such final decrees: an order for the allowance of costs and expenses to a complainant suing on behalf of a trust fund, a decree in a foreclosure suit fixing the compensation to be paid to the trustees of the

¹ *McLeod v. City of New Albany*, 66 Fed., 378, 381; 1895; C. C. A., 7th Circuit, "Being parties to the suit, they were in fact parties to the intervening petition." *Central Trust Company v. Madden*, 70 Fed., 451; 1895; C. C. A., 4th Circuit.

² *U. S. Fidelity Co. v. Bray*, 225 U. S., 205, 214; 1914. *McLish v. Roff*, 141 U. S., 661; 1891.

mortgage, a decree upon an intervening petition in respect to cars used by a railroad company under a contract with the manufacturers.

Plainly an order *granting* a motion to intervene is not a final disposition of the claim of an intervenor, and therefore from it an appeal never lies.

The question of the appealability of orders *denying* motions to intervene is not so easily disposed of. *Ex parte Cutting*, 94 U. S., 14, 1876, held that an appeal did not lie from an order refusing stockholders leave to intervene and to become parties to a foreclosure suit, the court saying, "that was only a motion in the cause and not an independent suit in equity appealable here." By an "independent suit" the court doubtless meant what is described in *Williams v. Morgan*, 111 U. S., 684, 1884, at 699, as "a matter distinct from the general subject of the litigation — a matter by itself which affected only the parties to the particular controversy and those whom they represented." The court also said in *Ex parte Cutting* that such an application "is always addressed to the sound judicial discretion of the court." In *Credits Commutation Company v. U. S.*, 177 U. S., 311, 1900, the facts were that a company claiming to have the right to connect its tracks when completed with those of a railroad company, against which suits were pending to foreclose a mortgage, petitioned to be allowed to intervene in those suits; the lower court denied the application; the Circuit Court of Appeals held that there was no right of appeal; and the Supreme Court sustained the Court of Appeals. The Supreme Court said the petitioner had a good remedy by independent suit; therefore the order was *not* final and *was* discretionary; only where the denial of the petition to intervene is a practical denial of relief to which the intervenor is fairly entitled and which he can only obtain by intervention is the order of denial final and therefore appealable. "Cases of this sort," says the court, "are those where there is a fund in court undergoing administration to which a third party asserts

some right which will be lost in the event that he is not allowed to intervene before the fund is dissipated."

It would seem to follow from these opinions that

(1) orders denying the right to intervene *and to become a party* complainant or defendant, whether to enforce a paramount right or to protect rights which it is alleged that the party to the record representing the petitioner has failed properly to protect, are not appealable, and

(2) orders denying a petition to intervene *pro interesse suo* are sometimes appealable and sometimes not, the test being whether or not the petitioner has any other remedy that is of real value.

But (1) cannot be considered as an accepted rule in view of a decision of the Circuit Court of Appeals for the Second Circuit.¹ The suit was to foreclose a collateral trust mortgage. A bondholder petitioned to be allowed to intervene as a party defendant, not for the purpose of setting up any defense to the mortgage, but for the purpose of objecting to the manner in which the sale was to be made. The bondholder alleged that the trustee was not properly representing him and other bondholders who had not deposited their bonds under a plan of reorganization with a bondholders' committee, of which the president of the trustee was a member. On an appeal from an order denying the petition of the bondholder the order was reversed and the petition granted. The court was of the opinion that the subject matter of the mortgage might, after sale, be scattered so as to make an independent action by the bondholder to set aside the sale of no practical value.

I turn now from these incidents of the foreclosure suit to the suit itself — what is being done, while the rights of preferred

¹ *Central Trust Co. v. Chicago, R. I. & P. R. Co.*, 218 Fed., 336, 1914, C. C. A., 2d Circuit. See *Investment Registry v. Chicago & Milwaukee Electric Ry. Co.*, 213 Fed., 492, 1914.

creditors and intervenors are being adjudicated, toward the accomplishment of its purposes: the foreclosure of the mortgage and the sale of the mortgaged property?

Often, for a long time, nothing. Intervenors may be claiming to own valuable portions of the terminals of the company or of its line; persons may be claiming preferences for large amounts; and the trustee and the bondholders may deem it essential to have these questions settled before a sale of the property is ordered. Or the railroad may have been kept out of the hands of receivers too long, and in the struggle of the railroad company to meet its obligations out of insufficient earnings, its equipment may have become inadequate and its roadbed unsafe. With the railroad in the possession of the court earnings formerly used for interest and moneys borrowed on receivers' certificates may be devoted to the improvement of the property. Bondholders and stockholders alike may wish to see such expenditures continue for a year or two in order to find out what the railroad is capable of under favorable financial conditions. For these and other reasons no one, it may be, concerns himself with thoughts of foreclosure and sale. In such circumstances not infrequently the railroad company fails to answer the bill; and the complainant nevertheless takes no step to enter a decree. It is usually well, however, for the trustee of the mortgage, if the railroad company defaults in pleading, to enter a decree *pro confesso* at the earliest opportunity. There is no legal reason why a creditor or stockholder should be allowed to intervene in order to defend in behalf of the railroad company on any less complete showing of a good defense before decree than after; as a matter of fact, however, when it is a question of opening a default the rule that such a showing must be made seems to be applied with more strictness, and it is easy for the court to say to a bondholder, as Judge Lurton did in *Central Trust Company v. Cincinnati, H. & D. Railway Company*, 169 Fed., 466, 1908, where the holders of \$2,000,000 of bonds petitioned for leave to intervene and become defendants and to file an answer and

cross bill for the purpose of having it declared that practically all the remaining bonds of the same issue, some \$15,000,000, were invalid :

"It is not necessary before a decree for sale under such a railway mortgage that the validity or ownership of every bond secured by it shall be first determined. . . . The mortgagor company makes no defense and a decree *pro confesso* has been taken long since. . . . There exists, then, all that is necessary for a decree *nisi*. It is undoubtedly proper practice, if not always essential, that such a decree *nisi* shall definitely disclose the nature of the default and the amount of principal and interest due as a consequence. This is to fix the amount which the mortgagor must pay in to prevent a sale, for it is necessary that a reasonable time be allowed for such redemption, for otherwise a valuable right of the mortgagor may be destroyed. But in order to declare and determine the amount of bonds due and outstanding and the amount of interest due and unpaid, it is not essential that the bonds and coupons shall be produced and proved. The necessary declaration of the amount to be paid in order that the mortgagor may redeem is not regarded as final or conclusive upon the point of the amount of the debt, for it is well settled that any holder of such bonds who presents them for a dividend out of the proceeds of sale may challenge the claim of any other when the allowance will diminish his own share in the fund. . . . Indeed it is proper in any such decree to require that all holders of bonds shall present them to a special master and that all persons claiming a right to share in the proceeds of sale shall have the right to challenge the right of anyone presenting a bond to the special master for such purpose."

But if a decree had not been entered the court might well have hesitated before denying the petitioners the right to have it settled before the foreclosure sale whether the total amount of valid bonds was two million dollars or seventeen million. Great harm may be done to a bondholder if it is not decided before the sale what bonds are valid and what invalid. Let us suppose, for instance, that in the case from which I have just quoted, the mortgaged property was actually worth one million dollars, and that in all probability the property in a few years would be worth two million dollars. The petitioners owning the two million dollars of bonds might be willing to buy it in

for that amount, if their bonds were the only valid ones, for in that event all the cash they would need as purchasers would be an amount for expenses, allowances, and so on, as they could make payment of the rest of the purchase price by crediting the amount of it on their bonds. Or if they did not care to buy the property but wished merely to get as much cash as possible for their bonds, they could bid up to a million dollars and let the property go at that figure to some other bidder and receive from the proceeds of the sale a dividend of approximately fifty per cent.

If, however, it is unsettled at the time of the sale, whether the other fifteen million dollars of bonds are valid or not, the holders of the two million dollars of bonds cannot bid without running the risk of ultimately being held liable to pay fifteen-seventeenths of their bid in cash. This means that the holders of the two million dollars of bonds are practically deprived not only of their right to take a chance of getting payment in full in a few years, but of a certainty of getting a dividend of fifty per cent in cash at once, for against a committee representing holders of the fifteen million dollars of bonds, the holders of the two million dollars of bonds will not dare to bid even one million dollars, still less two million, with the possibility that they may be called upon to pay most of the bid in cash; nor will any outside purchaser appear at the sale because everyone knows the committee will outbid everyone else. The committee will consequently be able to bid in the property at less than its value say five hundred thousand dollars, so that even if the two million dollars of bonds are ultimately held to be the only valid ones, the holder will receive a dividend of less than twenty-five per cent. Nor can this injustice to the minority bondholders be remedied by fixing a price in the decree below which the property shall not be sold, for such an upset price could hardly be greater than one million dollars, the value of the property; and even if it were fixed and obtained the minority holders would have lost the chance of making the face of their bonds by buying in

the property. Moreover, fixing an upset price and getting it are two different things. If no one bid the amount fixed the court would have to reduce it.

It is only in a limited number of cases such as where the mortgage and the bonds are absolutely void under some constitutional or statutory provision, or the bonds have been fraudulently issued and are in the hands of the original holders that there is a real defense to a foreclosure suit; for where the power to make the mortgage or the bonds exists, defects in the mode of executing the power such as irregularities in calling meetings of stockholders to authorize the mortgage or the bonds, or even complete failure to hold such meetings, are waived by payment of interest for several years¹ and other acts of ratification and acquiescence.

The railroad company frequently neither defaults nor puts in an answer, but gets from the trustee extensions of time to answer; stockholders and general creditors having notified it that unless the opportunity to put in a defense is kept open until a plan of reorganization satisfactory to them is proposed by the bondholders, they will ask to be allowed to intervene on the ground that the railroad company is in collusion with the trustee in not setting up some alleged defense. Sometimes a plan satisfactory to all parties is soon agreed upon and a decree is entered without opposition; sometimes the bondholders, general creditors and stockholders are obstinate, a change is made in the directors of the railroad company, or stockholders are allowed to intervene, and an answer is filed attacking the validity of the mortgage or the bonds. Evidence is taken; and negotiations continue. Finally the parties interested get closer together; the times are favorable for launching the reorganized company, selling bonds to raise money for the improvement of the property, and so on, or there is fear that bad times are

¹ *Farmers' Loan & Trust Co. v. Toledo, A. A. & N. M. R. Co.*, 67 Fed., 49, at p. 59; 1895.

approaching, and everyone is anxious to end the litigation and get the property out of the courts; the bondholders raise their offer to the stockholders, the stockholders lower their demands, and all come to an agreement; enough additional evidence is added to justify a decree; and the decree is entered.

All that is necessary for a decree is to prove that the mortgage was executed and delivered and that the bonds were executed and certified and are outstanding. Ordinarily, the method of proof is as follows: the mortgage is produced from the files of the trustee; then the secretary of the railroad company and the secretary of the trustee or their respective assistants and someone who presented coupons and made demands for payment of interest and of principal are called as witnesses: by them it is proved that the signatures and the seal of the company are genuine; that the mortgage was recorded in various states and counties, the fact usually appearing from the endorsements on it; that meetings of stockholders and directors were held and at them resolutions, which are put in evidence, were adopted authorizing the mortgage and the bonds; that bonds to a certain amount were executed by the company, certified by the trustee, and issued, under the provisions of the mortgage, to take up other bonds of the company or to pay debts or to raise money; that interest was paid on them for several years; that they appeared as outstanding liabilities in the annual reports sent to the stockholders of the company; that default was made in the payment of interest after demand and subsequently the principal was declared due by the trustee and default was made in the payment of that.

The testimony of the officials of the railroad and the trustee are frequently to what they know only from the records of their offices, the records themselves being presented for inspection. It is not necessary to produce the bonds themselves or to prove who the owners are; all that being reserved for the hearing before the master on the distribution of the proceeds of sale, when, notwithstanding by the decree of foreclosure it may have

been adjudged that the whole issue is valid and outstanding, every holder is at liberty to attack the validity of the bonds of every other holder.

When there is a contest, what is the procedure? Formerly almost always an order of reference was made to a master to take testimony and report. The master took testimony wherever and whenever it was convenient for counsel. The new rules provide that "In all trials in equity the testimony of witnesses shall be taken orally in open court, except as otherwise provided by statute or these rules," and "save in matters of account a reference to a master shall be the exception, not the rule, and shall be made only upon a showing that some exceptional condition requires it." Nevertheless it is likely that the manner of trying a contested foreclosure suit will remain as before, by a reference to a master.

Masters' reports are of two kinds:

(a) What may be called the ordinary report of a master in chancery under an order of reference which the court has power to enter over the opposition of any or all of the parties; and

(b) A report made by a master under an order to hear and decide all the issues in a case. Such an order of reference can be made by the court only upon consent of all the parties.¹

What is the weight to be given the findings in report (a)? Statements can be found in the cases and textbooks answering this question in various ways; it is said that the report is advisory only;² that its "office is to present the case to the court in such a manner that intelligent action may be there had,"³ and that while the findings of a master are not absolutely binding upon the court, there is a presumption in their favor and they will not be set aside or modified in the absence of some clear error or mistake.⁴ A finding on a disputed question of

¹ *Kimberly v. Arms*, 129 U. S., 512; 1889.

² *Boesch v. Graff*, 133 U. S., 697, 705; 1890.

³ *North Carolina R. R. Co. v. Swasey*, 23 Wall, 405, 410; 1874.

⁴ *Boesch v. Graff*, 133 U. S., 697, 705; 1890.

fact it is said will not be disregarded, unless the finding "appears to be palpably wrong by the most persuasive weight of evidence."¹ It may, perhaps, be said that the court gives to the findings in what I have called the ordinary report of a master the weight that the Appellate Division of the New York Supreme Court gives to the findings of a lower court in an equity case.

When the report of a master is confirmed by the court, the findings are not necessarily conclusive on the court of appeals. All that can be said is that the confirming of the report gives the findings added weight. In a case where the court of appeals set aside the report of a master, the court said that it was not unmindful of the rule that the findings of a master concurred in by the court to which they were reported were presumptively correct and would be permitted to stand unless there was an obvious error of law or important mistake of fact, but that a master's findings have not the force of a verdict or of the report of a referee, and on exceptions thereto the court must determine by its own judgment the controversy presented, and on appeal the court of review, of course, has the same power and responsibility.²

I have said that a reference to a master to hear and decide all the issues can only be made on consent of all parties. When so made the findings of fact are more conclusive than those in an ordinary master's report; and have, what the circuit court of appeals says the latter have not, the force of a verdict or of the report of a referee. In a case where the order of reference made by consent of parties was "to hear said causes and report to this court his findings of fact and conclusions of law" the Supreme Court said:

" . . . we think that his finding, so far as it involves questions of fact, is attended by a presumption of correctness similar to that in the case of a finding by a referee, the special verdict of a jury, the findings of a Circuit Court in a case tried by the court under Revised Statutes,

¹ *Fordyce v. R. R. Co.*, 145 Fed., 544, 557; 1906.

² *Bosworth v. Hook*, 77 Fed., 686; 1897.

Section 649, or in an admiralty cause appealed to this court. In neither of these cases is the finding absolutely conclusive, as if there be no testimony tending to support it; but so far as it depends upon conflicting testimony, or upon the credibility of witnesses, or so far as there is any testimony consistent with the finding, it must be treated as unassailable." ¹

Out of a creditor's bill or of a bill to foreclose a mortgage other suits may arise before the entering of a decree of sale. There may be several mortgages of the same railroad company in default, two divisional mortgages and a general mortgage covering the entire property of the railroad company. Each divisional mortgagee may claim priority of lien upon some particular portion of the road. If one of the divisional mortgagees is the first to begin a foreclosure suit, it makes the other divisional mortgagee and the general mortgagee parties defendant. If either of these defendants wishes to foreclose its mortgage it files what used to be called a cross bill and is now — or perhaps it is safer to say — may be under equity rules 30, and 31, a set-off or counter-claim. A cross bill is a bill filed by a party defendant to an original bill against some or all of the other parties to the bill. Defendants to the original bill may be residents of the same state and in the cross bill be on opposite sides; the federal court nevertheless has jurisdiction. *Shields v. Barrow*, 17 How., 129, 145, 1854, is a leading case to the effect that no new party may be brought in by cross bill, the reason given being that to allow it would open the door for the indefinite extension of the jurisdiction of the federal courts. This reason seems to have no application to cross bills in cases where the court has possession of the property, because that mere fact extends the jurisdiction to all suits for the possession or control of the property. In practice it has not been uncommon to bring in without objection new parties as defendants to cross bills.

We now come to the decree.

In the preparation of a decree which is to be entered both in

. ¹ *Davis v. Schwartz*, 155 U. S., 631; 1895.

the creditor's suit and the foreclosure suit, it is necessary to have in mind the disposition of three funds :

1. the moneys in the hands of the receiver ;
2. the proceeds of the sale of the mortgaged property and, if more than one mortgage is being foreclosed, the proceeds of the properties covered by the respective mortgages, and
3. the proceeds of the unmortgaged properties ;

and the rights and obligations of the following persons or sets of persons :

1. the trustee of the mortgage ;
2. bondholders ;
3. receivers ;
4. holders of receivers' certificates and other creditors of the receivers ;
5. intervenors ;
6. preferred creditors ;
7. other creditors ;
8. the railroad company ;
9. the purchaser.

If the decree says nothing about the earnings in the hands of the receiver they do not pass to the purchaser, but are distributable, so far as they are not applied to the payment of preferential claims, among the bondholders. Sometimes the decree provides that the receivers shall turn such earnings over to the purchaser.

The proceeds of the property covered by the mortgage or mortgages, as the case may be, the decree gives to the bondholders entitled thereto, usually, but not always, providing, as we shall see later, that there shall first be paid out of such proceeds the receivers' indebtedness and preferred claims.

The proceeds or property not covered by the mortgage or mortgages, the decree provides shall be distributed among all creditors entitled to share therein. Bondholders have the same right to share as other creditors. The question whether preferred claims which are entitled to be paid out of the corpus should be paid out of the unmortgaged property rather than

the mortgaged, has not been much discussed ; usually no one is interested in raising it, as the value of the unmortgaged property is small, the amount for which the bondholders are entitled to prove against the unmortgaged assets is very large in proportion to the unsecured debts, and the bondholders and unsecured creditors are parties to the same reorganization agreement.

In theory the railroad company may be able to raise the money necessary to save its property from sale and therefore the decree should fix the exact amount, whether due to bondholders or to preferred creditors or as allowances to receivers and trustees and counsel, upon payment of which the company may get its railroad out of the hands of the court. In theory too, the property will bring a higher price if the decree describes with precision what is to be sold and what the rights and liabilities of the purchaser are to be than if anything is left unsettled ; therefore, in order to get the most for the railroad company and its creditors, the decree should be so framed as to tell intending bidders exactly what they will get if they buy and exactly what responsibility in dollars and cents they are assuming when they bid.

But in practice such precision in the decree is found to be unnecessary, for the court and everyone else know that the railroad company cannot possibly get the money to pay what it owes ; and they know in ninety-nine cases out of a hundred that there will be only one bidder. A railroad mortgage securing bonds to the amount of fifty million dollars is foreclosed in this country in the same way as a mortgage for ten thousand dollars on a house. The only bidder at the foreclosure sale of a house is usually the owner of the mortgage. Whether he bids one thousand dollars or ten thousand dollars, the amount of cash which he has to pay is nearly the same : enough to cover the expenses of the sale. The rest of the purchase price he pays by crediting the amount of it as a payment upon the mortgage bond. The bondholders, when their mortgage is about to be foreclosed, endeavor to get themselves into the position of the owner of the

mortgage on the house, a position where they can act as one man. They deposit their bonds with a committee under an agreement authorizing the committee, among other things, to form a plan of reorganization and to purchase the property at foreclosure before or after the plan has been formed or approved. Before the sale a plan has been usually agreed upon with committees representing general creditors and stockholders, under which a reorganization committee, composed of representatives of all classes of creditors and stockholders, holds at the time of the sale a great majority of the bonds and outstanding claims and stock. If the committee represents all of the bonds it is able to bid fifty million dollars as inexpensively as to bid one million. If the committee has only forty-nine million dollars of the outstanding fifty millions, the higher it bids the more cash it will have to pay in order to provide money to pay the bondholders who have not deposited their bonds the dividend to which they are entitled as their share of the purchase price. Usually the amount of bonds held by the committee is so large in proportion to undeposited bonds that no attempt is made by the holders of the latter to bid up the price at the sale and the committee gets the property at what it chooses to bid; the court endeavoring to secure the holders of undeposited bonds a reasonable payment by fixing an upset price. If, at the sale, no one bids this price, the fact is brought to the attention of the court which then lowers the upset price for the next sale.

So far, therefore, as the railroad company and its bondholders and general creditors and stockholders ordinarily are concerned, it is of no real importance that a theoretically perfect decree of sale should be made. The railroad company is an empty shell; its bondholders, creditors and stockholders are going to be the purchasers and to be, with such people as agree with them to put fresh money into the property, the bondholders and stockholders of the new company which is to own the road after foreclosure sale. The important thing when the parties in interest are ready for a decree is not so much the form of the decree as

the speed with which the property can be transferred from the possession of the officers of the court to the possession of its owners. The courts recognize the desirability of this change and are willing to hasten it by entering decrees which leave many things unsettled. They have held, therefore, that it is not necessary to adjust all the disputed claims of original parties and intervenors growing out of foreclosure proceedings before ordering a sale.¹ All that is "indispensable in such a decree" of foreclosure and sale

"is that there should be declared the fact, nature and extent of the default which constituted the breach of the condition of the mortgage and which justified the complainant in filing his bill to foreclose it and the amount due on account thereof which, with any further sums subsequently accruing and having become due according to the terms of the security the mortgagor is required to pay within a reasonable time to be fixed by the court and which if not paid a sale of the mortgaged premises is directed."²

The receiver and the holders of debts due by the receiver and of preferred claims and liens of minor importance, the extent or priority of which the mortgagee is contesting, are seldom concerned with the question of whether decrees of sale are so framed as to bring the highest possible price; for they are otherwise satisfactorily cared for by provisions in decrees varying according to circumstances. Where the railroad is a valuable property, everyone knows that claims entitled to priority of payment will be paid by the new company as soon as it gets possession and they can be adjusted, and often more speedily and inexpensively than if they were dealt with in court proceedings; and therefore a provision in the decree that the purchaser shall take the property subject to preferred debts, receivers' certificates, allowances and the like — with a reservation by the court of the

¹ *Alabama & G. Mfg. Co. v. Robinson*, 72 Fed., 708; 1896. *Guaranty Trust Co. v. Metropolitan Street Ry. Co.*, 168 Fed., 937; 1909; affirmed on this point 177 Fed. 925; 1910.

² *Chicago & Vincennes R. R. Co. v. Foedick*, 106 U. S., 47, at page 70; 1882.

right to retake the property if payment of any claim is not made promptly by the purchaser — is all that is really necessary for the protection of such claims. On the other hand, where the railroad is a poor one, the courts have found that after reorganization it is sometimes soon back in court with preferred claims or even debts of the old receivership unpaid, and, therefore, when they are doubtful about the future of a property, the courts try to make the payment of receivership debts and expenses and preferred claims certain, by providing in the decree that an amount which they consider sufficient to meet all such claims shall be paid in cash.

The courts now often leave out provisions that used to be in decrees which rendered the purchaser uneasy, but were of little if any practical benefit to anyone; such, for example, as the requirement that the purchaser should not only take subject to all the debts of the receiver and unpaid preferred claims, but should personally agree to pay them. When no time was fixed by the decree within which such claims had to be presented, and by the order appointing receivers all sorts of claims were made preferential, the purchaser did not know until the statute of limitations had run what his liabilities might be. The present day decree usually limits the claims to those which have been already presented to the court, or which shall be presented within a fixed time; and does not require the purchaser to agree to pay such claims, but merely to take the property subject to their payment. Sometimes when the decree requires that the purchaser shall agree to pay such claims, it provides that if the purchaser assigns his bid to a new company, the liability to pay on the part of the bidder shall cease and shall attach to the company.

In the interest of the purchase at foreclosure sale it is now always provided that the purchaser shall be allowed to defend against all unsettled claims subject to which he takes the property and shall have the right to appeal from decrees allowing them. In the absence of an express provision or of some-

thing from which such a right can be implied the purchaser has no such right.¹

It is now customary also to insert in the decree clauses, the effect of which is in the language of the court in *Wabash Railroad Company v. Adelbert College*, 208 U. S., 38, 53, 1908, "to say to any purchaser under it you must take this property subject to all claims which this court shall hereafter adjudge to be lawful and you may be assured that you will be held to pay none other, and for the purpose of making this statement good, the court reserves jurisdiction over the property and claims in respect to it. . . ." The court said, page 55, that, except for the presence of such clauses in the decree of foreclosure, under *Shields v. Coleman*, 157 U. S., 168, 1895, the exclusive jurisdiction of the federal court would have terminated with the receivership; but, as it was, the jurisdiction of the federal court survived and consequently a decree of a state court made in a suit, — which had been begun before the suit in the federal court, — adjudging a lien upon the property which had been sold by the federal court, must be reversed.²

I shall end by giving a rough draft of a decree :

1. — That the mortgage is a valid lien upon the railroad and other property described in the decree ; that bonds to a specified amount secured by the mortgage have been duly executed, certified by the trustee and issued and are outstanding in the hands of the public ; that default has been made by the defendant railroad company in the payment of principal or interest as the case may be, and that a specified amount is due by the railroad company to the holders of the bonds and coupons.

2. — That the mortgagor within twenty days, or some other fixed period after entry of the decree, shall pay to the trustee of the mortgage the amount found due with interest from the date of the decree.

¹ *Swann v. Wright's Executor*, 110 U. S., 590, 601; 1884.

² See also *Julian v. Central Trust Company*, 193 U. S., 93; 1904.

3. — That unless such payment is made the special master appointed by the decree shall sell at public sale the property which is subject to the lien of the mortgage, both that described in the mortgage and any other property which may have been acquired during the receivership or otherwise and which passes under the mortgage. In describing the property the decree uses broad words, such as all the property covered by the mortgage, and then adds a full description.

4. — That any purchaser may turn in as part of the purchase price bonds and coupons secured by the mortgage foreclosed or receivers' certificates or other obligations payable ahead of the bonds and coupons, and be credited with the amount which would be payable thereon if the entire purchase price were paid in cash; and that the securities so turned in shall be stamped so as to show payment thereon of the amount with which the purchaser has been credited and shall then be returned to the purchaser unless the amount of the payment is equal to the full amount due thereon.

5. — That the proceeds of the sale of the property shall be applied :

(a) to the payment of the costs of the complainant, the receivers and the trustee and their respective counsel, and their charges and allowances;

(b) to the payment of receivers' certificates and the debts of the receivership generally;

(c) to the payment of amounts due to creditors entitled to a preference;

(d) to the payment of the bonds, principal and interest, or if the proceeds shall be insufficient for full payment, to the payment thereof ratably as far as the proceeds will go.

This last provision is varied to fit the terms of the mortgage. Sometimes coupons which were due before the foreclosure suit was begun are directed to be paid in full.

If the decree is solely in the foreclosure suit it usually provides that any surplus shall be held subject to the further order

of the court. If the decree is a decree both in the foreclosure suit and the creditor's suit it either reserves the disposition of the surplus for a further decree, or it directs that the surplus together with the proceeds of any unmortgaged property directed to be sold, or any other moneys or property in the possession of the receiver not covered by the mortgage shall be applied, after paying an allowance to counsel for the complainant creditor and preferential claims, to the payment of all creditors entitled to share in the proceeds of unmortgaged property, and that the master, before whom general creditors have been directed to file their claims, shall report to the court the amount of moneys so applicable and the amount of claims which are entitled to share in such property.

The decree sometimes provides that an amount in cash must be paid by the purchaser sufficient to pay everything which the decree requires to be paid before the bonds; but not always, as those having preferential claims are often satisfied with other provisions for their payment which the decree usually makes and which appear later on.

6. — That the purchaser as a condition of the purchase, shall take subject to all pending contracts of, and all indebtedness and liabilities incurred by, the receivers, and all allowances and expenses and preferential claims which shall not be paid out of the proceeds of sale, and shall save harmless and indemnify the receivers; that in case the purchaser after demand shall refuse to pay or discharge any such obligation or perform any such contract the person holding the claim may, upon ten days' notice to the purchaser or his successors or assigns, file his petition to have the claim enforced against the property, that the purchaser or his assigns may appear and make defense to such claim, and that either party may appeal from any decree, order or judgment made thereon;

That the court retains jurisdiction for the purpose of enforcing these provisions; and reserves the right to retake and sell

the property in case there shall be a failure to comply with any order in regard to the performance of such a contract or payment of such a liability.

7. — That the Master shall sell at a time to be fixed by him at the request of the solicitor for the trustee or after consultation with the court at a place named in accordance with Section 1640, Volume I of the Compiled Statutes of the United States, usually some railway station on the line of the road; and that the Master shall give notice of such sale in accordance with Section 1642 by publication once a week for four weeks in such newspapers as are named in the decree including one printed, issued and circulating in a county where some part of the railroad lies, the notice to contain a brief general description of the property to be sold and place of sale and a reference to the decree for a more particular description. Power is given to the Master to adjourn the sale by announcement at the time of the sale upon consent of the solicitors for the complainant or with the approval of the court.

The decree usually fixes an upset price.

8. — That any party to the cause or any holder of the bonds or receivers' certificates, may purchase at the sale and hold the property in his own right free from any trust or right of redemption. If the foreclosure is under one mortgage only, unless there is some very strong reason to the contrary, the Master is directed to sell the property in one parcel as an entirety. If the decree is one for the foreclosure of several mortgages, one of which is general, covering the entire property, and two of which say are divisional, that is covering parts of the property only, the decree directs that the property upon which the divisional mortgage A is a lien shall be first offered for sale and the price bid be noted; that the property covered by divisional mortgage B shall next be offered as a separate parcel and the bid noted; that the entire property shall then be offered as

a whole and if the price bid for the entire property is greater than the total of the prices bid for the two parcels the bid for the entire property shall be accepted, but if the total of the amounts bid for the separate divisions is greater than the price bid for the property as a whole, the bids for the divisional properties shall be accepted; and that in case the bid for the entire property is accepted the proceeds are to be deemed attributable to the properties covered by the two divisional mortgages respectively in the proportions which the bids for those properties bear to one another.

9. — That no bid shall be received from any bidder unless he shall first deposit a certain sum in cash with the Special Master or a certified check or receivers' certificates, or bonds or coupons, to a named amount, to be returned to him if his bid is not accepted; otherwise to be treated as part payment of the purchase price. The court reserves the right to reject any bid and also to retake and resell the property upon the failure of any purchaser to comply with the terms of sale.

10. — That the receivers file with the clerk of the court before the sale an inventory to include as complete a list of indebtedness, obligations and contracts as possible, such inventory to be deemed advisory and not to constitute a warranty; that the enumeration in such inventory or the decree of any lease or executory contract to which the railway company is a party shall not be deemed an adoption of such lease or contract by the court or by the receivers; that at any time after the confirmation of the sale and before the delivery to the purchaser of the property the court will direct the receivers to take such action as to adopting or not adopting such lease or other contract as the purchaser may request upon receiving proper indemnity from the purchaser; that any purchaser shall be allowed a certain time, three months or six months or a year from the date of confirmation, within which to elect to adopt

or to refuse to adopt any lease or other executory contract which may be included in the properties sold and in the event of the failure to file a statement refusing to adopt the lease or contract the purchaser shall be deemed to have elected to adopt it; that the court reserves the power to direct the payment by the purchaser or by the receivers of such amounts as shall be found to be equitable upon an accounting or otherwise in respect of any lease or traffic or trackage agreement which the purchaser shall elect not to adopt, and jurisdiction is reserved to enforce such payment; that the court reserves the power and jurisdiction to deliver to a purchaser or purchasers title to and possession of the property and to determine all controversies as to the character, extent and validity of the title and possession of such purchaser or purchasers acquired through the execution of the decree.

11. — That upon confirmation of the sale and compliance with the terms of sale by the purchaser, the Master shall make proper instruments of conveyance and assignment, in which the receivers, the railroad company and the trustee of the mortgage and every person holding the record title for any of the property conveyed shall join, and shall deliver the same to the purchaser.

12. — That the purchaser receiving such instruments shall be vested with and shall hold possession of the property and all the rights and franchises subject to the provisions of the decree as fully and completely as the mortgagor or its receivers at the time of the decree hold or enjoy or have theretofore held or enjoyed the same, and in particular shall hold them freed and discharged from the lien of the mortgage which has been foreclosed and from any claim of the mortgagor, its stockholders, creditors and receivers and of any party to the cause and any person claiming by, through or under them, or any of them, except as specifically provided in the decree.

The court finally reserves for further determination all matters of equity not expressly adjudged in the decree and

any party to the cause is authorized to apply for further order and direction. The term of the court at which the decree is entered is sometimes extended until after the complete execution of the provisions of the decree.¹

After the expiration of the time given to the railroad company to pay the amount adjudged due, the trustee files an affidavit of non-payment.

The notice of sale is then published. The description of all real estate owned by the company other than the rights of way should be as full as possible. The important provisions of the decree should also be stated in the notice; and it should wind up with a particular reference to the decree for all further details.

After the sale the master makes a report to the court. Where the sale has been made under the decrees of several courts and the same master has been appointed under all the decrees as he always is, his report to the different courts recites his appointment under these different decrees. The report should show strict compliance with all the conditions of the decree and of the general law necessary to the making of a valid sale; and should state that the purchaser was the highest bidder; that he signed a memorandum of the sale, has complied with all the preliminary terms and conditions, and is entitled to a conveyance upon full payment as provided by the decree of sale.

At the time of this report, the purchaser enters his appearance, and files his petition for confirmation of the sale. He refers to the report of the master, and if he is a representative of the reorganization committee, as he usually is, he says he is prepared to deliver to the master, in order to have credited thereon as part of the purchase price the dividend

¹ *Guaranty Trust Company of New York v. Metropolitan Street Railway*, 177 Fed. 925; 1910.

applicable thereto, bonds, or receivers' certificates, or whatever it has been provided by the decree may be accepted, and he offers in all respects to comply with the terms of his purchase, subject to all the provisions in the decree of sale. He prays for leave to intervene and to be made a party to the suit, and that the report made by the master be approved and confirmed. The trustee moves also for the confirmation of the report. Ordinarily the report of the master, the petition of the purchaser to intervene and the motion to confirm, are all made at the same time, the various parties to the suit waiving their right to file exceptions, and consenting that the petition and the motion may come on for hearing at once. On the same day, the decree of confirmation is made. This decree should recite in detail that all the things have been done or have happened, which, by the decree of foreclosure, were precedent to the right of the master to make the sale, and that all things have been done subsequent to the sale to entitle the purchaser to a decree of confirmation.

**THE REORGANIZATION OF CORPORATIONS; BOND-
HOLDERS' AND STOCKHOLDERS' PROTECTIVE
COMMITTEES; REORGANIZATION COMMITTEES;
AND THE VOLUNTARY RECAPITALIZATION OF
CORPORATIONS**

**A Lecture Delivered before the Association of the Bar of the City of New
York, by Paul D. Cravath, March 1 and 8, 1916.**

THE late Adrian H. Joline — and no lawyer of his day had a more varied contact with corporate reorganizations — said in one of his Harvard lectures delivered in 1910, that after an experience running over a period of thirty years, he found it about as difficult to tell how to reorganize a corporation as it would be for a poet to tell how to write poetry. One cannot formulate many rules or refer to many precedents which will serve as a guide to the reorganizer, for each reorganization differs more or less from all others. I can therefore do little more than offer a series of practical suggestions based upon experience. This should be the most helpful method of approaching our subject, because in few branches of practice does experience count for more and there are none in which the books furnish so little help.

I shall deal chiefly with the legal, rather than the economic and financial aspects of reorganizations, although in a great measure the legal and business questions are very closely intertwined. Usually it is not the duty of a lawyer to give advice to his client on economic questions. If you tell him what he may lawfully do, you may usually leave it to him to decide what he may wisely do. But in reorganizations, particularly if your clients are inexperienced in reorganization practice, it is often the duty of counsel to advise them both as to the practical and legal aspects of the questions presented for decision.

A plan of reorganization, however lawful, will bring disappointment and discredit to its authors if its terms are not such as to command the support of security holders. It is quite as important to propose a plan which will be supported by the security holders as one which will be supported by the courts. In both aspects it is important that the plan should be fair and just, for even after it has been accepted by a majority of the security holders, the courts are very apt to find a way of upsetting it, if it presents elements of unfairness or oppression.

You will get some idea of the practical importance of this branch of professional activity when I tell you that during the past twenty-five years railroad corporations owning about one-half of the total mileage of the United States have been subjected to the process of reorganization or readjustment and that over eighty railroad corporations, owning about forty-two thousand miles of railroad or about sixteen per cent of the total mileage of the country, with an aggregate capitalization of about two million and a quarter dollars, are now in receivers' hands and awaiting reorganization. In addition, a surprisingly large proportion of the great industrial enterprises of the country, including several which are now enjoying sensational prosperity, have passed through some form of reorganization. United States District Judge Hough of this District ¹ recently estimated that fifty per cent of the corporations of to-day have gone through some form of reorganization in the last twenty years.

Definitions

The term "reorganization," as applied to corporations, may somewhat loosely be defined as the rearrangement of the financial structure of an incorporated enterprise, rendered necessary by insolvency or by the inability of the corporation to secure the necessary funds for its operations because of obstacles resulting from its financial structure. Corporate reorganiza-

¹ Southern District of N. Y.

tions usually, though not always, follow, and are based upon, the foreclosure of mortgages or the enforcement of the rights of creditors in some form.

Reorganizations of corporations which are insolvent or suffering from a defective financial structure are sometimes accomplished by the voluntary action of the security holders. It is to such operations that the term "readjustment" is usually applied, although in some measure the terms "reorganization" and "readjustment" are used interchangeably. A recent illustration of the common use of the terms is furnished by the Plan for the Readjustment of the Capital and Debt of The Missouri Pacific Railway Company, which was first offered for the voluntary acceptance of the security holders in the hope that their acceptance of the Plan would render the foreclosure of mortgages unnecessary. It was then spoken of as a "Plan of Readjustment." It was not accepted by the security holders with sufficient promptness to avert a default in the interest payments under various mortgages, upon which the trustees thereupon instituted foreclosure proceedings. The same Plan, although not changed, automatically came to be called a "Plan of Reorganization" instead of a "Plan of Readjustment."

There are cases where, without the spur of insolvency or financial necessity of any kind, corporations are, to use a common expression, "recapitalized," that is, their corporate or financial structure is changed for some reason other than to meet financial stress, as, for instance, to increase or decrease the amount of stock outstanding, to replace bonds by stock or *vice versa*.

Our subject therefore naturally divides itself into three divisions:

First: Reorganizations based on the foreclosure of mortgages or the enforcement of other rights of creditors and involving the organization of a new corporation to acquire the property which is the subject of the reorganization;

Second: Readjustments of the debt or share capital of corporations because of insolvency or financial needs of some sort where the property is not transferred to a new corporation ;

Third: The recapitalization of corporations for some other purpose than to meet insolvency or correct defects of financial structure and which may be accomplished either with or without the transfer of the property to a new corporation.

REORGANIZATIONS BASED ON THE FORECLOSURE OF
MORTGAGES OR THE ENFORCEMENT OF OTHER RIGHTS
OF CREDITORS AND INVOLVING THE ORGANIZATION OF
A NEW CORPORATION TO ACQUIRE THE PROPERTY
WHICH IS THE SUBJECT OF THE REORGANIZATION

I shall deal chiefly with reorganizations based upon defaults under, and the foreclosure of, mortgages. By far the greater number of reorganizations, and almost all railroad reorganizations, come under this head.

In order to make our discussion more definite and concrete, let us assume that you are dealing with an insolvent railroad corporation which has several bond issues, each secured by mortgage, issues of preferred and common stock, and a substantial floating debt in addition to its ordinary current operating debt for wages, supplies and the like. We shall assume that this railroad company is about to default in the payment of interest upon one of its mortgages and that you are consulted by the banker by whom the bonds secured by that mortgage were issued and who therefore has an interest in seeing that proper steps are taken to protect those bonds. In practice this is the way in which a reorganization usually starts. We will assume that it is recognized that the railroad company can no longer pay the interest upon its bonds and that a default under, and the foreclosure of, the mortgage is deemed inevitable.

The Appointment of Receivers

The first step is to bring about the appointment of a receiver or receivers with sufficient power to protect, and continue the operation of, the property pending foreclosure and reorganization. I say "pending reorganization" because, as was said by Chief Justice Waite in *Canada Southern Railway Company v. Gebhard*,¹

"It rarely happens in the United States that foreclosures of railway mortgages are anything else than the machinery by which arrangements between the creditors and other parties in interest are carried into effect, and a reorganization of the affairs of the corporation under a new name brought about."

It rarely is safe to delay the application for the appointment of receivers until a foreclosure bill, based upon a default under the mortgage, can be filed, for when it becomes notorious that a corporation is nearing insolvency and that a default in the payment of its fixed charges is imminent, it is difficult to obtain the necessary credit to enable it to continue its operations. There is also the danger of attack by creditors either by attachment or by unfriendly receivership proceedings. The experienced reorganizer stands in special dread of an unfriendly receivership proceeding which may force the property into the hands of a receiver who is incompetent or who is under the direction of a court lacking the necessary powers effectively to administer a property running through several States. The special danger from this direction lies in the fact that the law is well settled that the court in which the first receivership bill is filed is entitled to appoint the receiver, assuming that the allegations of the bill are sufficient to support the appointment.²

Mr. Byrne has stated in his lecture the reasons why a receivership in the Federal Courts is preferred to one in the State Courts and has outlined the procedure in receivership proceed-

¹ 109 U. S. 539; 1883.

² *Farmers' Loan and Trust Co. v. Lake Street Elevated R. R.*, 177 U. S. 51; 1900.

ings in the Federal Courts. He has also told you the methods ordinarily adopted in order to have receivers appointed as speedily as possible in all jurisdictions in which property of the corporation is situated. I wish to emphasize what he has said in regard to your right deliberately to select, as the creditor who is to file the bill, one whose citizenship is such that he can go into the Federal Court for the express purpose of securing a receivership in that court rather than in the State Court, and your right to arrange that the creditor's bill should be submitted to counsel for the corporation and that all the procedure should be agreed to in advance.

Only last month, the United States Circuit Court of Appeals of this Circuit expressly approved the action of the Board of Directors of a large industrial corporation, organized under the laws of New Jersey, in filing an answer admitting the allegations of a creditor's bill brought in this District and joining in the prayer for the appointment of a receiver, where it clearly appeared that the creditor had been requested to file a bill and that it had been filed with the knowledge of the Company's Board of Directors and counsel for the avowed purpose of securing the prompt appointment of receivers by the Federal Court.¹

I have emphasized the so-called "Consent Receiverships" in the Federal Courts because, as the result of the apparently widespread misapprehension regarding them which has been current of late, counsel are very apt to attempt to do by indirect and circuitous methods what they should do directly and openly.

I refer you to Mr. Byrne's lecture for a discussion of the difference between a chancery receivership and a statutory receivership and for the procedure in respect of ancillary receiverships in the Federal Courts. It may be, as was recently remarked by a distinguished New Jersey Vice-Chancellor, that "the jurisdiction which the Federal Courts have thus worked out

¹ *Guaranty Trust Company of New York v. International Steam Pump Company*, 231 Fed. 594; 1916.

. . . is somewhat extraordinary," but it is a most effective system. It possesses an elasticity and capacity to be molded to meet emergencies which is not possible under any system regulated by statute. A system of ancillary receiverships all centering around a primary receivership avoids the conflict and working at cross-purposes which are inevitable where the administration of a property is in the hands of several State Courts, and the Federal Courts have built up a system of precedents which guide the practitioner in meeting most of the emergencies that arise in the administration of complicated properties.

In the case of industrial corporations organized under the laws of New Jersey, it has recently been found necessary to supplement a Federal Receivership by a receivership in the State Courts under the New Jersey Corporation Act.¹

The Circuit Court of Appeals for the Third Circuit has held that the proceedings in the Federal Court for the appointment of receivers and the distribution of assets were conducted under the New Jersey statutes and could accomplish all the results contemplated by those statutes excepting the dissolution of the corporation.² This view, however, has not been accepted by the New Jersey Courts. In *Gallagher v. Asphalt Company of America*,³ the New Jersey Court expressed the opinion that the New Jersey Courts were the proper tribunals for the exercise of the rights created by the statute. In several recent instances⁴ where the primary receivers were appointed by the United States District Court for the Southern District of New York, the New Jersey Court of Chancery, upon the application of stockholders made under the New Jersey statutes, appointed a separate receiver, who was, however, instructed not to inter-

¹ §§ 63, 64 and 65; *Conklin v. United States Shipbuilding Co.*, 140 Fed. 219; 1905.

² *Land Title & Trust Co. v. Asphalt Co. of America*, 127 Fed. 1; 1903.

³ 65 N. J. Eq. 258; 1903.

⁴ E.g., *International Steam Pump Company* and *International Mercantile Marine Receiverships*.

fere with the administration of the assets in the possession of the Federal Receivers, but simply to take possession of any assets which were not in the possession of the Federal receivers, and to stand ready to receive any assets which might be turned over to him by the Federal receivers. I think it may now be regarded as settled practice that where receivers of a New Jersey corporation are appointed by the Federal Courts there should be a receiver appointed by the New Jersey Court of Chancery under the New Jersey statutes to represent the corporation and act as the protector of the rights of its stockholders.¹

It is the usual, although not the invariable, practice in the Federal Courts, at least in this district, to appoint two receivers, one suggested by the applicant, frequently an officer of the corporation, and the other an independent person chosen by the court, usually a lawyer. The usual preference of the court to appoint at least one person of its own selection as an independent receiver is justified by the very grave responsibility assumed by the Federal Court in receiverships, which makes it proper that at least one of the receivers should be a person having the full confidence of the Court and known to the Court to be free from bias and entanglements. As has been well said, the Receiver is "the eyes," "the ears," and "the hands" of the Court and should be "absolutely impartial."

In the case of an insolvent industrial corporation, bankruptcy has one advantage over an equity receivership, namely, that the trustee in bankruptcy receives title to the property wherever located, thus avoiding the necessity of instituting an ancillary proceeding in every jurisdiction in which the corporation has property. Among the disadvantages of a bankruptcy proceeding over an equity receivership are the necessity of strictly complying with statutory requirements with the resulting inelasticity of procedure, statutory limitations upon the power of the bankruptcy court to permit the continuation of

¹ See *Gallagher v. Asphalt Company of America*, 67 N. J. Eq. 441; 1904.

the business, and the impatience of the bankruptcy court to secure an early sale and distribution. In the case of industrial corporations of large magnitude, an equity receivership is much to be preferred to bankruptcy. An equity receivership is no insurance against bankruptcy proceedings, for it is within the power of three creditors to force bankruptcy on an insolvent corporation within four months after the act of bankruptcy which is often involved in an equity receivership. Railroad companies are not subject to bankruptcy proceedings, which can be instituted by creditors only against a "moneyed, business or commercial corporation, except a municipal, railroad, insurance or banking corporation."¹

The Foreclosure of the Mortgage

Having secured the appointment of receivers, your next important step would normally be the foreclosure of the mortgage so soon as a default permitting foreclosure has occurred. In that event the receivership would, to use a common expression, be extended to the foreclosure suit, which means that the persons who were appointed receivers upon the creditor's bill would also be appointed receivers under the foreclosure bill.

The primary foreclosure suit should, in turn, be followed promptly by the filing of an ancillary foreclosure bill in each of the other circuits in which there is mortgaged property and in each of those ancillary suits an order should be entered appointing ancillary receivers. I will not follow the proceedings in the foreclosure suit because they have been described in Mr. Byrne's lecture.

It is to the interest of your committee that the creditor's suit and the foreclosure suit should be confined to the necessary parties and your tactics should be directed to that end. Those who wish to harass you are very apt to seek leave to intervene in the creditor's suit or in the foreclosure suit, so that they will

¹ Bankruptcy Act, § 4.

become entitled to an opportunity to oppose all proceedings. Courts are more liberal in admitting intervenors in creditors' suits than in foreclosure suits. Judge Lacombe in the *Metropolitan Street Railway* receivership proceedings adopted the policy of admitting as parties to both creditors' and foreclosure suits the committees representing substantial holdings of securities, including the stock, and of excluding all other applicants.¹ This practice of admitting committees is not general.²

Ordinarily, bondholders will not be admitted as parties to a foreclosure suit instituted by their trustee, but in the recent Rock Island case,³ the Circuit Court of Appeals of this Circuit⁴ admitted a minority bondholders' committee upon the theory that the attitude of the Trust Company, which, as trustee of the mortgage, was complainant in the foreclosure suit, was "ambiguous," it having appeared that its President was also Chairman of the majority bondholders' committee with which the minority bondholders' committee was at odds. This decision raises a question as to the wisdom of the practice, which has heretofore been common, of appointing an officer of the trust company which is trustee of the mortgage, a member of the committee to represent bonds secured by the mortgage.

The Protective Committee and the Deposit Agreement

While you have been preparing the receivership papers, it may be assumed that your client, the banker, has been engaged in forming a bondholders' protective committee, in which event it becomes part of your task to draw the Bondholders' Protective Agreement appointing the committee, defining its powers and providing for the deposits of bonds thereunder. The terms of such an agreement, of course, vary with circumstances, but its primary purpose is to confer upon the committee the power

¹ *Pennsylvania Steel Co. v. New York City Ry. Co.*, 160 Fed. 222; 1908.

² *Metropolitan Street Railways* case, 181 Fed. 285; 1910.

³ *Central Trust Co. v. Chicago R. I. & P. R. Co.*, 218 Fed. 336; 1914.

⁴ Second Circuit.

to take any action it may deem necessary or proper for the protection of the bondholders and the enforcement of their rights in the foreclosure proceedings or in any other proceedings affecting the mortgaged property. The powers conferred in this regard cannot well be too broad. The purpose of the agreement should be to place the committee practically in the position of owners of the bonds, with power to exercise all the rights and pursue all the remedies conferred by the mortgage. Under modern mortgages, the action of the trustee is usually placed, subject to certain limitations, under the control of the holders of a designated proportion of the bonds, and it is important that the protective committee should, so soon as practicable, have on deposit at least the proportion of the bonds in which that control is vested.

The usual parties to the agreement are the bondholders' committee and the depositing bondholders, or rather, the holders of the certificates of deposit issued by the depositary appointed by the Committee to receive deposits of bonds, usually a trust company. It is not usual to require bondholders to sign the agreement, but machinery is provided whereby the bondholder automatically becomes a party by depositing his bonds and accepting a certificate of deposit issued by the depositary. These certificates of deposit may be transferable on transfer books kept by the depositary, or they may be in bearer form and transferable by mere delivery.

If the bonds are listed on the New York Stock Exchange, the certificates of deposit should be engraved or printed on engraved forms which most Trust Companies have on hand. So soon as a substantial amount of bonds have been deposited, the certificates of deposit should be listed, for listing increases their availability as collateral for loans and therefore encourages deposits. If listing is contemplated, a registrar for the certificates of deposit must be appointed.

Certificates of deposit representing securities deposited under a protective agreement are frequently referred to as "nego-

tiable." The term, however, is used loosely as meaning transferable by delivery, for such a certificate is not a negotiable instrument in a technical sense. I shall not take time to discuss the interesting question as to how far the qualities of negotiability may be conferred by agreement in respect of an instrument which does not meet the definition of a negotiable instrument.¹

The contract resulting from the deposit of securities under a deposit agreement is rather a peculiar one. It imposes no affirmative liability on the depositor. He ceases to be a party to the agreement the moment he transfers his certificate to another. It is practically an agreement *in rem* which follows the certificate into the hands of any holder. If the certificates are payable to bearer, there is no way of identifying the holders at a particular time. Effective notice to them can be given only by publication in the manner prescribed in the agreement. In case of default by the depositor in meeting the conditions of deposit, there is no remedy against him individually, but the remedy is by forfeiture or sale of the property represented by his certificate. The provisions of the agreement in this regard must therefore be clear and precise. The records of any action taken for the forfeiture or sale should be carefully preserved because the certificate holder may turn up to assert his rights years after the event.

I will not attempt to indicate in any detail what should be the provisions of a protective agreement, whether it be for bonds or unsecured obligations or stock, but I will tell how you may simplify your task in preparing such an agreement if you pursue the course most lawyers do. Do not attempt to evolve the agreement out of your own consciousness, for it would take you days to work out clauses covering half of the contingencies for which provision should be made. If you

¹ See *In re Goy & Co., Limited* (1900), 2 Ch. 149; *In re Brown & Gregory, Limited* (1904), 1 Ch. 627; *Goodwin v. Roberts* (1876), 1 App. Cas. 476; *France v. Clarke* (1884), 26 Ch. Div. 257; *Evertson v. Bank*, 66 N. Y. 14, 19; 1876.

have not a model for such an agreement in your own office, go to some friend, a lawyer or banker or broker, and get from him a copy of the deposit agreement used in some previous transaction of such magnitude and dignity that the agreement must have been the workmanship of some experienced and competent counsel. You can, without much difficulty, find a model which, with some change, will fit almost any situation. It is then a comparatively simple task to eliminate the provisions which are inapplicable to your situation and to add the provisions required by its special circumstances.

I do not intend to give you the impression that the greatest care is not required in the preparation of such an agreement, for few instruments call for greater care or more painstaking attention to detail. It is your Committee's grant of power and it should be broad enough to cover every emergency with which the Committee is likely to have to deal. There will be no opportunity to correct mistakes, because there will be as many parties to the agreement as there are holders of certificates of deposit — there may be thousands of them — and the agreement cannot be changed without the consent of each.

There are a few comments applicable to protective agreements under almost all circumstances. In the first place, do not place too great reliance upon the effectiveness of the general clauses which appear in most deposit agreements and which purport to give the Committee power to do almost anything it chooses. So far as possible, have a specific grant of power for everything the Committee is likely to be required to do, remembering that your Committee is a trustee for its depositors and that the agreement may be strictly construed against it. In *United Water Works Company, Limited, v. The Omaha Water Company*,¹ a bondholders' committee had been appointed under an agreement which described a very simple plan of reorganization and provided that in case the Committee purchased the property at foreclosure sale it should

¹ 164 N. Y. 41; 1900.

"prior to the conveyance of any purchased property to the new company, submit to the certificate holders a *detailed plan* of reorganization, which shall be binding upon all said holders, unless the holders of a majority in interest of the outstanding certificates shall, within thirty days, file with the Trust Company their written dissent from said plan."

The agreement then provided that

"The Committee may supply any defects or omissions in this plan which it shall deem necessary to be supplied to enable the Committee to carry out the general purposes of the plan; and with the consent of the holders of a majority in interest of the outstanding certificates, may take any action other than is provided for in this plan which the Committee shall unanimously determine to be for the benefit ratably of all of the certificate holders."

The Committee, having purchased the property, submitted a detailed Plan of Reorganization which differed from the original Plan in that it allotted a certain interest in the new company to stockholders and created a voting trust. The Court of Appeals held that because of this departure the failure of a majority to dissent from the modified Plan within thirty days did not result in the adoption of the detailed Plan. In other words, the provisions of the original agreement creating the machinery for the modification of the Plan applied only to modifications which were consistent with the original Plan.

Another excellent illustration of the danger of relying upon the broad clauses giving general grants of power is furnished by the recent decision of Judge Mayer of this District ¹ in *Titus v. United States Smelting, Refining and Mining Exploration Company*.² In that case a bondholders' protective agreement, after providing that the committee could do certain things, provided that the money and securities in its hands might be used "for such other purposes as the committee in its uncontrolled discretion may determine." The Court held

¹ *Southern District of N. Y.*

² Not yet reported.

that this grant of power, although apparently unlimited, must be controlled by the manifest purposes of the agreement and that a contract by which the committee turned over the property to a stranger for exploration and development was beyond its power, because the protective agreement did not authorize the committee thus to surrender its discretion.

The Protective Agreement should provide that the Committee shall have power to add to its number, to accept resignations of its members and to fill vacancies. There should be express provision authorizing the Committee to act by a majority and permitting members to vote by proxy, and suitable provisions for protecting the Committee and Depositary against mistakes. The Committee should have the power to employ accountants, engineers, counsel and other experts, arrange for their compensation and for other expenses and hold or pledge the deposited securities as security therefor. The agreement usually provides that the Committee's decision as to its own compensation, as well as its expenses, shall be binding upon the depositors. There is no doubt that this provision is effective so far as the Committee's expenses, incurred by it in good faith, are concerned, but it is questionable whether any provision in an agreement appointing trustees can make them the final arbiters of their own compensation.

It is therefore advisable that provision should be made by which the Committee's compensation may ultimately be fixed by agreement or by the exercise of some independent judgment. A protective agreement usually fixes a maximum limit to the Committee's compensation and expenses. In the case of reorganization agreements the usual method of meeting the problem is to provide that the approval of the Committee's compensation by the board of directors of the reorganized company shall be conclusive. Such a provision is doubtless effective unless the board of directors is so made up as to be under the domination or influence of the committee. It is often provided that a statement of the Committee's compensation and expenses

shall be filed with the depositary and shall be deemed approved by all depositors unless objections are made within a specified period.

A protective agreement usually confers upon the Committee power to adopt a plan of reorganization of its own devising or one prepared by some one else. It is not usual to give a protective committee power to adopt a plan without first submitting it to the depositors. The common provision is to require that any Plan and Agreement shall be lodged with the depositary subject to examination by all depositors and that a notice of the filing of the Plan, but not describing it, be published at stated intervals for a specified period. Usually the agreement provides that depositors who are dissatisfied with the Plan may, within a designated period, say thirty days after the first publication of the notice, withdraw their securities upon surrender of their certificates of deposit and making a contribution, at some specified rate, toward the expenses and compensation of the Committee. Under such a notice the holders of certificates of deposit who do not withdraw their securities within the specified period automatically become bound by, and parties to, the Plan and Agreement of Reorganization.

Protective agreements sometimes provide that the Plan of Reorganization shall become binding upon all depositors if within a specified period after publication of the notice of the filing of the Plan the holders of a specified proportion of the deposited securities do not file with the depositary notice of their dissent from the Plan. In this case, the dissatisfied minority may be bound by the failure of the satisfied majority to dissent from the Plan.

In order to insure that depositors shall not have the right to withdraw securities until after the announcement of a Plan of Reorganization, the agreement should expressly so provide and should show also some consideration running to the depositors, such, for instance, as covenants on the part of the

Committee to endeavor to protect the interests of the depositors and to formulate a Plan of Reorganization. In the case of *Colonial Trust Co. v. Wallace*,¹ the United States Circuit Court of Appeals for this Circuit² held that under the form of deposit agreement then usually used which gave depositors the right of withdrawal within a certain period after the announcement of a Plan of Reorganization, the right of withdrawal accrued immediately upon deposit and was not dependent upon the announcement of a Plan.

In view of the decision of our Court of Appeals in *Industrial & Trust Co., Ltd. v. Tod*,³ the agreement should expressly provide that a Plan of Reorganization may be proposed after, as well as before, a foreclosure sale of the property.

This very interesting decision affects many questions involved in the preparation, construction and enforcement of protective and reorganization agreements. In that case a bondholders' committee was created under a deposit agreement which, in the language of Judge Vann's opinion, "conferred almost unlimited powers upon them." The agreement specifically authorized the Committee to purchase the railroad at foreclosure sale and to use the bonds in payment of the purchase price. It also authorized the Committee to prepare a Plan of Reorganization, but did not specifically provide whether this should be before or after the purchase of the property. The agreement contained the usual provisions for giving notice of the filing of the Plan and affording to dissatisfied bondholders an opportunity to withdraw. The Committee purchased the railroad at the foreclosure sale, paid for it by the use of the deposited securities and subsequently prepared, filed and announced a Plan of Reorganization. The Industrial & General Trust Company, a depositor of bonds, although it did not exercise the privilege of withdrawal, protested against the Plan of Reorganization and brought suit against the Committee for conversion. The Court of Appeals held that a suit for con-

¹ 183 Fed. 897; 1910.

² Second Circuit.

³ 180 N. Y. 215; 1905.

version did not lie,¹ whereupon the complaint was amended to a cause of action for breach of contract. The Court below dismissed the complaint. Its judgment was affirmed by the Appellate Division but reversed by the Court of Appeals, Judge Vann writing the prevailing opinion and Judge Gray the dissenting opinion, in which Judge O'Brien concurred. In the prevailing opinion the Court reached the following instructive conclusions: (p. 225)

1. That "as the reorganization agreement was prepared by the committee, and the language used is wholly their own, it should be construed most favorably to the bondholders, who had no part in preparing it, but were compelled to accept it as it was, or not accept it at all."
2. That under the broad provisions of the agreement to the effect that the Committee's construction of its provisions should be final, the Committee (p. 226)

"were doubtless protected from the outcome of errors of judgment and honest mistakes, but good faith is the standard, erected by the law, by which all their acts and omissions are to be judged,"

and that, therefore, no provision, however strong, could shield the Committee from liability unless good faith is observed.

Judge Gray in the dissenting opinion expressed the view, as did the Appellate Division, that the provisions in question did protect the Committee in the action which they had taken.

3. That while there was no express provision to the effect that the Plan of Reorganization should be promulgated prior to the acquisition of the property by the Committee at foreclosure sale, there being no provision to the contrary, there was an implied obligation on the part of the Committee to propose the Plan of Reorganization prior to the sale in order that dissatisfied bondholders might have an opportunity of withdrawing their bonds and protecting themselves at the foreclosure sale.

¹ *The Industrial & General Trust Limited v. Tod*, 170 N. Y., 233; 1902.

The facts before the Court seemed to make this a hard case, and the decision went very far, but the cautions which it gives to draftsmen of protective and reorganization agreements are too striking to require comment.

In practice, members of a committee are frequently owners of securities of the issue which it is their duty to protect and they may wish to be free to purchase further securities of the same issue as well as certificates of deposit issued by the Depository. The agreement should expressly authorize such transactions. It should also authorize the members of the Committee to form, or take part in, syndicates for underwriting the cash requirements of the Plan or otherwise aiding the reorganization. It frequently happens that the same banking firm is represented on the Committee, acts as reorganization managers, and also forms and manages the syndicate to provide the cash requirements. Manifestly the provisions permitting these inter-relationships must be clear, full and explicit.

The present rules of the New York Stock Exchange require that every protective agreement affecting listed securities shall fix a date by which depositors should be entitled either to their new securities or to the return of their old securities. It is usual to fix a date so far ahead, as, for instance, five years, to allow ample latitude.

The bondholders' protective committee having been formed and having executed the protective agreement and lodged it with the depository, the Committee should then give notice of its formation and call for the deposit of bonds. The notice is usually published as an advertisement and also mailed to bondholders in so far as their addresses are ascertainable. The notice of the formation of the Committee is sometimes published in advance of the actual preparation and execution of the deposit agreement, particularly if there is fear that another committee with an ambition to represent the same securities is in process of formation. There is, of course, a distinct advantage in your Committee being the first in the field with its announcement.

A bondholders' committee naturally does all in its power to encourage deposits. A common expedient to this end is an offer to depositors to purchase the maturing interest coupons or to advance the maturing interest upon the security of the depositor's bonds. The purchase of coupons is becoming less frequent than formerly because modern mortgages do not accord to interest priority of lien over principal and often contain provisions for subordinating the lien of purchased coupons to that of the principal. It is now more usual to offer to advance the maturing interest, at the depositor's option, upon the security of his bonds and coupons.

The announcement of the formation of your Committee is likely soon to be followed by the formation of other protective committees to represent other classes of securities, whether bonds or stock or unsecured claims, as the case may be. Or there may be a rival committee calling for the deposit of the bonds of the same issue as those for the protection of which your client's committee was formed.

If need be, you and your clients should arrange that committees are formed to represent the various other issues of securities which are likely to be dealt with in the reorganization, for, manifestly, when the time comes to prepare a Plan it is essential that there should be representatives of the other classes of securities with whom your clients can negotiate. Above all things, see to it that neither your Committee nor any other committee represents conflicting interests. It is a rule to which there are few exceptions that the same protective committee should represent but one class of securities. It is rarely wise that the same committee should even represent both preferred and common stock, because some of the most perplexing questions which arise in reorganizations are as to the equitable adjustment of the relative participation to be accorded to preferred and common stock.

I emphasize the importance to your clients of these suggestions regarding the formation of committees representing the

other classes of securities to be dealt with, because the success of the Plan of Reorganization finally adopted may be just as dependent upon the support of the holders of the other classes of securities as it is upon the support of the holders of the particular class of securities which your clients represent.

The same person should not be a receiver and a member of the committee representing security holders. In *Fowler v. Jarvis-Conklin Mortgage Co.*,¹ Judge Lacombe refused to remove a receiver simply upon the ground that he was a member of the reorganization committee, and said :

"Several Federal courts have approved of such a practice; and although this court entertains a different opinion, and will require absolute neutrality on the part of its officers, as between conflicting plans of reorganization, it will be sufficient if the receiver, now that some conflict over the plan of reorganization is foreshadowed, promptly resign from membership of the committee."

The suggestions I have made regarding the importance of having a separate committee to represent each class of securities are made upon the assumption that protective committees are being formed with a view to ultimate negotiations looking towards a Plan of Reorganization. It occasionally happens that a Plan of Reorganization is prepared by a banking firm or by a self-appointed committee without having previously called for the deposit of securities. In such a case, the first announcement made is of the Plan of Reorganization in which the holders of the various classes of securities are invited to participate. In such a case a single committee, or a banking firm acting as reorganization managers, may undertake to act for the security holders of all classes in carrying out that particular plan, for presumably there will be no clash of interests between the various classes of security holders in carrying out a definite Plan to which they have indicated their adherence. In such a case the proponents of the Plan announce that they have prepared a Plan of Reorganization which they regard as

¹ 63 Fed. 888; 1894.

fair to all the interests affected and invite the various classes of security holders to participate in it. But even in such a case there is danger of embarrassment in case a modification of the original Plan should become necessary, for the reorganizers may find themselves in the position of making changes that will be favorable to one class of security holders and unfavorable to another. Such a modification would not be attempted, of course, without submitting it to the security holders for their adoption or rejection, but there is the risk of losing their support simply because they would feel that there had been no independent representation of the various conflicting interests. Accordingly, experienced counsel sometimes prefer in cases where a Plan of Reorganization is announced in advance to provide for a separate representation for each important interest affected by the reorganization.

We have now completed the first stage of our campaign. The property is in the hands of receivers, a bill to foreclose the mortgage securing our bonds has been filed, a bondholders' protective committee has been formed, the agreement defining its powers has been lodged with the depositary, and the publication of the notice calling for the deposits of bonds has begun.

I have not time to deal with the infinite variety of intermediate questions with which you will have to deal as counsel to the bondholders' committee in case the property is an important one and the conditions of the receivership are at all complex. In railroad reorganizations you are apt to have interesting problems arising out of the issue of receiver's certificates and the application of the rules which have been worked out by the Federal courts according priority to claims arising out of the current operations of the property. These, which have come to be popularly known as "six months claims," have been discussed in Mr. Byrne's lecture.

The Plan and Agreement of Reorganization

We will now pass on to the stage when your clients feel that a Plan of Reorganization should be adopted. It is assumed that in the meantime a majority, and the larger the majority the better, of the bonds secured by the mortgage have been deposited with your Committee and that progress has been made with the foreclosure proceedings. One of the fundamental rules of tactics which you should always have in mind as counsel for a bondholders' committee is to press your foreclosure proceedings to an early decree. This will require constant pressure and constant vigilance, because the foreclosure proceedings are conducted, not by yourself, but by counsel for the trust company which is trustee of the mortgage, and counsel for trust companies are proverbially busy. If possible, get your decree of foreclosure before the adoption of a Plan of Reorganization, for the Plan rarely suits every interest and is very apt to result in the formation of opposition groups disposed to adopt obstructive tactics for the purpose of securing modifications, and their best opportunity for obstruction is in the foreclosure proceedings.

Thus far it has been possible to suggest procedure in some measure applicable to most of the cases which are likely to arise, but when we approach the reorganization stage it is not possible to lay down fixed rules. Each reorganization presents its own questions and complications. I can therefore do little more than discuss some of the problems.

A Plan of Reorganization is usually the result of negotiations between two or more committees each representing a different class of securities. In the simplest reorganization there is, at least, a stockholders' committee and a bondholders' committee. In the more complex reorganizations, there will probably be a committee for the preferred stock, one for the common stock, and a separate committee for each of several classes of obligations; and there may be two or more committees representing securities of the same issue.

If the Plan of Reorganization results from an agreement on the part of several committees, there is usually a joint reorganization committee made up of representatives of the various committees which join in the adoption of the Plan, although sometimes the Plan is carried out by some one of the committees under an agreement with the others or by a banking firm acting as Reorganization Managers.

We will now assume that your clients, with your aid, have agreed with the committees representing the other interests upon the financial structure of the Plan of Reorganization and that you have been appointed counsel to the joint reorganization committee or the reorganization managers. You are now confronted with the preparation of the formal papers required in the adoption, promulgation and consummation of the Plan. The basic papers are the Plan and the Agreement of Reorganization.

I speak of the Plan *and* Agreement because it has become the custom to state the terms of the reorganization and the powers of the reorganizers in two papers, one the Plan, which contains the financial details of the reorganization, and such information regarding the machinery for carrying it out as should be communicated to the ordinary security holder. The other paper — the Agreement — is usually a much longer and more formidable document. It contains a fuller statement of the powers of the Committee, the rights of participants in the Plan and the machinery for carrying the Plan into execution. Few documents require so much elaboration and such frequent changes in their preparation as a Plan of Reorganization. In important reorganizations it is usual, both for convenience and precision, to begin securing printed proofs of the Plan during its early stages. It is not unusual for a Plan to pass through a score or more of proofs before it reaches its final form.

Again, I suggest that you get some classic model to serve as a skeleton for the body which you are to create. Thus you will not only save yourself a great deal of trouble, but you will

get the benefit of the experience of many able counsel during the last quarter of a century during which the law and practice regarding reorganizations have largely been developed, and furthermore, you will be adapting your Plan to established practices so that it will be more readily understood by the average investor and the average lawyer. Most modern Plans of Reorganization follow a general pattern and have a great many features in common. You will get some idea of the enormous accumulation of experience which is accessible if you will compare some modern Plan of Reorganization with one adopted, say, twenty-five years ago. You will find that the old plans follow no uniform scheme and while they are often very short and simple, they seem very inadequate to the modern practitioner.

Here I am tempted to digress to offer some reflections provoked by the length and complexity of modern reorganization agreements and corporate mortgages. There can be no doubt that instruments of this class have attained proportions, both in length and elaborateness of provision for all conceivable eventualities, of which the wildest imagination of the practitioner of fifty years ago could form no conception. The Wabash Plan and Agreement of Reorganization of 1915 is about three times as long as the Wabash Plan and Agreement of Reorganization of 1887. The Baltimore & Ohio Refunding Mortgage of 1915 is about thirty times as long as the typical Baltimore and Ohio mortgage of fifty years ago and eight times as long as its typical mortgage of twenty-five years ago. Illustrations might be multiplied indefinitely, but these few serve to illustrate my point.

There is a common impression that the modern long reorganization agreement or corporate mortgage is a delusion and a snare and that we should go back to the short and simple forms which our fathers used. That this idea is entirely wrong is known to any experienced lawyer of to-day who has had occasion to act under the typical reorganization agreement or

corporate mortgage of the early period. The provisions of the modern reorganization agreement and the modern corporate mortgage are the result of the experience and prophetic vision of a great many able lawyers. Every new provision is suggested either by some decision of the courts or by an actual experience or by some lawyer's conception of a possible exigency. Ordinarily in drafting a document a lawyer must draw chiefly upon his own experience and the results of his own observation, but corporate mortgages and reorganization agreements are public documents so that each lawyer can have the benefit of the experience of many others. It would indeed be a courageous man who would say that any of the provisions which some of these lawyers have conceived to be wise should be rejected simply because he cannot for the moment think when or how it will become useful.

I doubt not that the modern corporate mortgage and the modern reorganization agreement are needlessly long and needlessly complex, but the genius who has the combination of time, wisdom and experience materially to shorten and simplify, without weakening, them has not yet appeared. How difficult is the task is known to every experienced New York lawyer having occasion to pass upon a mortgage evolved by the wisest country lawyer or even by a leader of the New York Bar who has had the hardihood to discard precedent and attempt to draw a simple railroad mortgage or a simple Plan of Reorganization. I advise you to adhere to precedent and, in most cases, you will find the long reorganization agreement based on precedent much safer than the agreement half as long drawn by your neighbor who scorns precedent.

We now return from our digression to consider the typical Plan and Agreement of Reorganization. I hold in my hand a typical Plan and Agreement. On the cover of the first page are the names of the Joint Reorganization Committee, its counsel and secretary, the names of the various committees which joined in the adoption of the Plan and in the appointment of

the joint reorganization committee and the names of the depositary of each class of securities. Then follows the introductory statement which, without going into precise details, briefly presents the causes which led to the insolvency of the corporation, the measures taken by the committees for the investigation of the property, a brief summary of the results of that investigation and of the reasons why the Plan is regarded as effective to accomplish the purposes in view and is deemed to be fair to the various classes of security holders.

Then follows the Plan itself, which, as I have already said, is intended to give the financial details of the reorganization. It begins with a statement of the present securities outstanding, subdivided into underlying bonds which are not to be disturbed, and those which are to be dealt with under the Plan. Then follows a statement of the cash requirements, a description of the new securities, a statement of the distribution of the new securities among the various classes of existing securities, a table showing at a glance what the holders of each class of existing securities will receive under the Plan, the provision made for underwriting, a statement of the terms and conditions of the cash assessment to be paid by the assenting stockholders and bondholders, a statement of the capitalization and fixed charges of the new company, showing the reduction in capitalization and the reduction in fixed charges to be accomplished by the reorganization, the provision made for unsecured creditors, and the designation of the joint reorganization committee. Then follows what should be present in every Plan of Reorganization, a provision that the statements contained in the Plan have been compiled from sources believed to be accurate and reliable, but that certain of them are only approximate and none of them are to be construed as representations. There is then a precise statement of the method and terms of participation in the Plan by the various security holders showing under a separate heading what the holders of each class of securities must do in order to participate in the Plan. The Plan closes

with a reference to the agreement of reorganization and the statement that its provisions shall govern in case they conflict with the Plan.

Your effort should be to make the Plan clear, succinct and accurate, and, so far as possible, free from legal technicalities and unnecessary details. You should save for the reorganization agreement all provisions which are not deemed essential to inform the security holder regarding the essential elements of the Plan and the procedure for his participation.

The typical agreement of reorganization which I hold in my hand is thirteen pages long. The parties to it are the Joint Reorganization Committee, parties of the first part, the holders of the certificates of deposit issued by the various depositaries, parties of the second part, and the depositaries under the Plan, parties of the third part. This particular agreement proceeds upon the assumption that holders of securities shall join in the Plan by depositing their securities with the depositary of the proper protective committee. It is sometimes provided that holders of undeposited securities shall join in the Plan by depositing their securities with a new depositary appointed under the reorganization agreement. The former course is less likely to cause confusion, inasmuch as it provides for but one class of certificates of deposit representing each class of securities.

The purpose of the reorganization agreement is to give the Committee, as nearly as may be, authority to exercise all the powers of owner of the deposited securities and moneys for the purpose of carrying out the Plan and to provide a ready means for securing the assent of depositors to any modification of the Plan that the Committee may deem wise. It is very important that counsel should see that the powers conferred by the agreement are sufficiently broad to meet every probable emergency, because he would be chagrined beyond measure if it developed that through some omission in the Agreement the Committee lacked the power to deal with an emergency which should have been foreseen and was compelled to submit to the expense,

delay and risk involved in submitting to the depositors a formal modification of the agreement for the purpose of conferring additional power. The grant of power can hardly be too broad, so long as it is confined to the carrying out of the Plan which the Committee's constituents are asked to approve. Provided always that this limitation is preserved, you will be surprised to find how willing security holders are to place almost unlimited power in a committee of reputable men.

On the other hand, as no one can be certain that every emergency has been foreseen, it is important that the provisions for modifying the Plan and Agreement should be broad enough not only to provide for a modified Plan, but also for any increase in the powers of the Committee that may be required to carry out the original Plan. The agreement should be so drawn that any additional grant of power that may be required can be obtained by filing a statement of the modification with the depository which shall become binding upon all depositors unless they affirmatively exercise the privilege of rejecting the modification by the withdrawal of their securities.

Practical Questions Arising in Connection with Reorganizations

I shall now discuss a few of the practical questions which are apt to arise in connection with reorganizations.

The theory of a Plan of Reorganization based, as most reorganizations are, upon the foreclosure of one or more mortgages or upon the enforcement of the rights of creditors in some other form, is that the Reorganization Committee becomes the owner of the deposited securities. It acquires the property of the old company by purchase at the sale held pursuant to a decree of foreclosure or judgment and then transfers it to a new corporation which the Committee has organized, receiving as consideration therefor the new securities, whether obligations or shares of stock, or both, required to carry out the Plan. The Master's deed runs to the Committee's represen-

tative, who in turn executes a deed to the new corporation; or the Master's deed may run directly to the new corporation, the Committee's representative having assigned thereto his rights under his bid. The Committee thus becomes the owner of the new securities, subject to its obligation to distribute them pursuant to the Plan.

It is manifest that, in practice, a Reorganization Committee will always have to provide a certain amount of money — sometimes a very large amount. It must have money for its own expenses and for the distributive share of the proceeds of sale to which the holders of the obligations not joining in the Plan are entitled. Money is frequently required to retire receivers' certificates and underlying liens, and almost every reorganization provides fresh capital for the enterprise.

This money may be provided in a variety of ways, but it is usually provided by means of a so-called "assessment" upon the holders of the securities which represent the equity in the property junior to the obligations which are being enforced — an equity which, presumably, would be wiped out by the strict enforcement of those obligations. The Committee, in effect, says to the holders of these junior securities, usually stockholders: if you wish to retain your equity or some share of it you must provide part or all of the cash required by the Plan. For the cash which the owners of the equity are thus required to provide as a condition to participation in the reorganization they are usually given some form of security, either new shares of stock or obligations.

Assuming that the control of the reorganization is in the hands of a Bondholders' Committee, its aim is to transfer to the stockholders the burden of furnishing the new cash required at the least possible cost to the bondholders. You may safely be influenced by the natural impulse of the average stockholder to protect his investment and to stay in the property even at the price of an additional investment involving some peril. It is usually wise not to require the payment of any assessment

with the deposit of securities, for the securities are usually sufficient security for the payment of the assessment when called.

I have used the term "assessment" as describing the payments required of stockholders and others interested in the equity as a condition to their participation in a reorganization because it is the term commonly used. It is, however, inaccurate, inasmuch as on final analysis the opportunity offered is to purchase from the Committee a portion of the securities which are to be issued to it by the new company in return for the property acquired and for the cash provided under the Plan. It is simply a sale of securities.

In order to insure the success of the Plan, it is usual to arrange in advance with bankers or with a syndicate to underwrite the cash requirements, that is, to agree to purchase such of the securities offered to the security holders interested in the equity as may not be taken by them. The announcement that the Plan has been underwritten usually has the effect of practically insuring the participation of the greater part of the security holders interested in the equity.

Underwriters usually receive a cash commission upon their maximum obligation. If all the security holders who are assessed pay their assessment, no payment is required of the underwriters and they simply receive their cash commission for the obligation which they have assumed. If, on the other hand, only a portion of the security holders pay their assessment, the underwriters provide the remainder of the cash and receive, in addition to the cash commission, the new securities which would have gone to the non-assenting security holders had they assented to the Plan.

Plans of reorganization are rarely strictly logical. If they were, the practice would be to limit participation on the part of holders of the old securities to such of them as have a real interest in the property based upon its value as a going concern. For instance, with a property deemed to be worth \$12,000,000,

against which there are \$10,000,000 of bonds, \$5,000,000 of preferred stock and \$10,000,000 of common stock, it can be seen at a glance that there is no equity for the common shares and the logical course would be to exclude them and confine the participation in the reorganization to the bondholders and the preferred stockholders. But this rarely happens in practice. Bondholders usually want to escape or reduce the burden of raising the new money required for the property by appealing to the impulse of the stockholders to protect their investment, so that stockholders are frequently offered a participation in the reorganization, conditioned upon the payment of an assessment, even though upon no theory of valuation would the aggregate value of the property exceed the amount of the prior securities.

The difficulty in securing underwriters to underwrite the assessment of stockholders whose equity is so attenuated that there is room for doubt as to their willingness to pay an assessment, may be met by requiring the holders of the securities next in line to act as intermediate underwriters of the assessment and forming a syndicate to underwrite the participation of this last class of securities. For instance, at the time of the promulgation of the Plan for the reorganization of the Wabash Railroad Company last year the market value of its preferred and common shares had dwindled to almost nothing. The cash requirements of the Plan were over \$27,000,000. The Plan levied an assessment of \$30 per share upon the preferred and common stockholders alike and for this assessment new Five Per Cent. Profit Sharing Preferred stock and common stock was offered. It was doubtful whether stockholders would, in any considerable number, pay the assessment, and it was manifest that a syndicate could not be formed to underwrite the participation of the stockholders. Accordingly, the Plan provided that the bondholders whose mortgage was being foreclosed should be required, in effect, to underwrite the participation of the stock, that is, to provide such part of the cash

requirements as was not furnished by the stockholders, and an underwriting syndicate was formed to provide such part of this remainder as the bondholders failed to pay.

Another interesting illustration is furnished by the recent reorganization of an important industrial company which had outstanding about \$10,000,000 of bonds, \$11,000,000 of preferred stock and \$17,000,000 of common stock. The property if sold at forced sale would not yield enough to pay the bonds. At the time the Plan was promulgated the bonds were selling on the market at about forty-four per cent. of par, the preferred shares at six per cent. of par and the common shares at three per cent. of par. The cash requirement of the Plan was about \$3,600,000, which was to be provided by an assessment of \$12.50 per share upon the preferred and common stock and new first preferred stock was to be issued at par for the cash assessment. The bondholders insisted that the preferred stock should underwrite the assessment of the common stock, that is to say, that to such extent as the common stockholders failed to pay the assessment of \$12.50 per share their place should be taken by the preferred stock, so that the syndicate practically underwrote the participation of the preferred shares. As a matter of fact, so strong was the impulse of the common stockholders to stay by their investment that they paid the assessment with substantial unanimity, leaving but an insignificant fraction of their burden to be assumed by the preferred stock.

An important question for counsel in connection with a modern reorganization is as to the aggregate amount of the new securities. I am not now referring to the financial aspects of the new capitalization, such as the amount of the fixed charges, the rate of interest upon the obligations and the rate of dividends upon the preferred stock, because those are questions which primarily concern the financier rather than the lawyer; I refer to the amount of capitalization which the law will permit, for that is a question primarily for counsel. In the old days, before we had public service commissions and before the

courts had begun seriously to enforce the laws regarding the liability to creditors of holders of partly paid stock, very little attention was paid to the amount of new securities so far as questions as to their validity or stockholders' liability were concerned. The lawyer usually was prepared to provide his client with as large an amount of new securities as he wanted. In those days, it frequently happened, particularly in the case of industrial enterprises, that reorganizations resulted in increasing the aggregate amount of securities outstanding, and reorganizers were very apt to try to make up for what the securities lacked in *quality* by increasing their *quantity*. In railroad reorganizations, practically the only limit of capitalization which was recognized was the par amount of the old securities plus the new capital.¹ Those days are past. Railroad reorganizations now, in most instances, must be approved by the public service commissions, and if the railroad which you propose to mortgage in carrying out your Plan happens to run through half a dozen States you are lucky if you do not have to deal with as many public service commissions. If your client has had the painful experience of having been forced to respond to creditors as the holder of stock which turned out not to be fully paid, he is apt, particularly in the case of industrial corporations, to insist that you assure him that the stock which he is to acquire is fully paid and carries no risk of personal liability to creditors.

There are as yet very few precedents and very few authorities to guide counsel in determining what must be done to make plans of reorganization conform to the requirements of the public service commissions of the various States, because very few large reorganizations have been carried through since public service commissions became the rule rather than the exception. The first of the present crop of reorganizations of interstate railroads escaped the public service commissions because the Plan did not involve the creation of a mortgage.

¹ See *Memphis & Little Rock R. R. v. Dow*, 120 U. S. 287; 1887.

The law seemed to be clear, in that case at least, that a corporation organized under the laws of one State to acquire an interstate railroad running through several States could acquire the property at foreclosure sale without consulting the public service commissions of the other States, but that any reorganization involving the creation of a mortgage would, in effect, have required the approval of the public service commission of every State into which the mortgaged lines extended.

The Plan for the reorganization of one of the great railroad systems now in receivers' hands, after having been worked out with infinite care and after months of negotiation, has just been halted by the first public service commission to which it was submitted, and their decision seems to recognize no fixed principles by which the reorganizers can be guided.

In the case of some railroad systems which must soon be reorganized the difficulties in the way of reorganization presented by the conflicting requirements of the laws of the various States concerned and possible conflict between the requirements of the public service commissions in the respective States are appalling. It is, I am sure, the ardent prayer of every railroad reorganizer, as it is of most railroad officials, that a Federal incorporation law will bring relief from the intolerable conditions resulting from conflicting State laws and clashing public service commissions.

In most States, the law makes it the duty of the public service commissions to limit the securities to be issued upon reorganization to the value of the property. In this State, the Public Service Commission law, enacted in 1907¹ at the instance of Governor Hughes, expressly provides that in valuing the property of a public service corporation as a basis for the issue of securities no value shall be attributed to the corporation's franchises beyond the amount paid the State therefor. When the insolvent street railway corporations of Manhattan and The Bronx came to be reorganized several years ago the

¹ *N. Y. Consolidated Laws.*

Public Service Commission for the First District insisted that the amount of the new securities which it would authorize was measured by the then value of the Corporation's property, exclusive of its franchises. The Court of Appeals, however, held in the *Third Avenue Railway Case*¹ that under the so-called reorganization statute² new securities could be issued at least to the amount of the old securities plus the additional cash paid in, regardless of the value of the property. The Legislature, however, promptly amended the law³ so that to-day, in the case of reorganizations, as in the case of new enterprises, the securities must not "exceed the fair value of the property involved."

Reorganizations of industrial corporations in this country are not under governmental supervision, nor are they, nor for that matter are railroad reorganizations in this country, subject to the supervision of the courts. In England, statutes require that Plans for the reorganization, or, to use the terms of the English statute, for the "reconstruction" of corporations, shall have the approval of the courts.⁴ The Plan must be filed by its proponents with the Court as a public document and an opportunity must be afforded to security holders to file objections upon which they are entitled to a hearing and the Plan does not become finally effective until it has been approved by the Court. It then becomes binding upon all security holders whether they have assented or not.

The limitations imposed by our Federal Constitution create difficulties in the way of working out in this country any scheme of public supervision of reorganization which would compel non-assenting security holders to accept plans of reorganization against their will or compel mortgagees or other creditors to surrender the right of doing as they please with

¹ 203 N. Y. 299; 1911.

² Stock Corporation Law, § 9 (*N. Y. Consolidated Laws*).

³ Public Service Commissions Law, §§ 55a and 69a (*N. Y. Consolidated Laws*).

⁴ English Companies Act, Part IV, Sections 129, 182, 199.

their own property. Without the power to compel the acceptance of reorganization terms by non-assenting security holders, I fear that public regulation of reorganizations, like so much other public regulation in this country, would simply mean the power to *harm* without effective power to *help*.

Twenty years ago Kentucky adopted a statute¹ regulating the reorganization of insolvent railroad and bridge companies which was modeled upon the English procedure. This statute was hailed as the beginning of a great reform by Mr. Moorfield Storey in his address as President of the American Bar Association in 1896, but even that statute recognized the constitutional difficulties in the way of the unrestricted adoption of the English system by providing that

"where claims have arisen or securities have been issued prior to the passage of this act, and any holder of such claim or securities shall object to the plan or reorganization, there shall be inserted in such a plan a provision for preserving and maintaining the right of such holder so as not to impair the obligation of his contract."

While the laws of several States either directly or in practical effect require that the reorganization of public service corporations shall be subject to supervision by their Public Service Commissions, no State, so far as I know, has followed the example of Kentucky in adopting a statute which attempts to make reorganizations approved by the Commission or by a certain portion of the security holders binding upon the non-assenting bondholders. Public regulation of reorganizations has very recently received the support of Judge Hough of the United States District Court for this District,² who in a recent opinion said :

"There is a good deal to be said in favor of a new scheme of law which would in some way confer upon an impartial and disinterested tribunal the entire supervision of corporate reorganizations. . . ."

¹ Kentucky Statutes, § 771-A.

² Southern District of N. Y.

³ *Guaranty Trust Co. of New York v. International Typesetting Machine Co.* (not yet reported).

Judge Hough added in a public interview that this "was . . . the expression of a hope" which he did "not expect to live to see realized."

There is an erroneous impression that the Federal Courts exercise supervision over reorganizations. Several years ago a United States Circuit Judge endeavored to use the power of the Court to force a Plan of Reorganization upon unwilling bondholders. The Plan was doubtless a beneficent one, but the United States Circuit Court of Appeals, presided over by Mr. Justice Brewer of the Supreme Court, very promptly convened and set aside the order.¹ Mr. Justice Brewer in his opinion said (p. 927):

"There is no wide discretion vested in the chancellor which permits him to disturb contract rights — rights of property,"

and quoted the language of the United States Supreme Court in *Kneeland v. American Loan Co.*,² where it said (p. 97):

"One holding a mortgage debt upon a railroad has the same right to demand and expect of the Court respect for his vested and contracted priority as the holder of a mortgage on a farm or lot. . . . We emphasize this fact of the sacredness of contract liens, for the reason that there seems to be growing an idea that the chancellor, in the exercise of his equitable powers, has unlimited discretion in this matter of the displacement of vested liens."

Mr. Justice Brewer goes on to say, referring to the Plan of Reorganization (p. 929):

"Now, that may be a wise business proposition, and if the court had power to take hold of these things and do for the people, who are mortgage bondholders, that which it thinks best for them, we might have no hesitation in sustaining this; but every man in this country decides questions in respect to his own property for himself."

There have, of course, been not infrequent instances in which the courts have successfully interfered with the execution of plans of reorganization, but, in every case, upon the

¹ *Merchants Loan & Trust Co. v. Chicago Ry. Co.*, 158 Fed. 923; 1907.

² 136 U. S. 89; 1890.

theory that some legal right was being violated, as in the well known *Monon* case,¹ where the Supreme Court upheld the power of a court of equity to set aside a foreclosure decree upon the ground that it was intended to carry out a conspiracy between the holders of the mortgage debt and the stockholders of the corporation to bring about a needless default under, and a foreclosure of, the mortgage, for the purpose of transferring the mortgaged property to a new corporation in which the stockholders of the old corporation should have an interest to the exclusion of the floating debt. When the case reached its second trial the Circuit Judge dismissed the charge of conspiracy and sustained the foreclosure decree.² There is no instance in the books, so far as I know, where, *at the instance of stockholders*, the courts of this country have interfered with plans of reorganization proposed by bondholders, unless the validity of the foreclosure decree could be attacked.

Three years ago the Supreme Court, in a decision foreshadowed by its opinion in the *Monon* case, placed a very serious and unexpected limitation upon the power of mortgage bondholders to deal in reorganizations with property purchased at foreclosure sale. I refer to the decision in *Northern Pacific Railroad Company v. Boyd*.³ If you are to have to do with reorganizations, you should know about this decision, because if you do not you are very likely to be subjected to the humiliation of being told about it by your client. In reorganizations of to-day a very large part of the time and energy of bondholders' committees and their counsel are devoted to discussion of the *Boyd* case and the possible means of meeting its requirements. It will accordingly be worth our while to consider it with some care.

The Northern Pacific Railway Company was reorganized about twenty years ago. The mortgage bonds and the re-

¹ *Louisville Trust Company v. Louisville, New Albany and Chicago Ry. Co.*, 174 U. S. 674; 1899.

² *Farmers' Loan & Trust Co., et al. v. Louisville, N. A. & C. Ry. Co., et al.*, 103 Fed. 110; 1900.

³ 228 U. S. 482; 1913 (*Boyd Case*).

ceivers' certificates aggregated \$157,000,000 and there was a large issue of stock. The reorganization was primarily a bondholders' reorganization based upon the foreclosure of their mortgage. The Plan of Reorganization gave to the old preferred stock 50 per cent in new preferred stock and 50 per cent in new common stock on paying an assessment of \$10 per share, and to the old common stock 100 per cent in new common stock on paying an assessment of \$15 per share. The aggregate assessment was \$11,000,000. The capitalization of the new company was to be \$190,000,000 in bonds, \$75,000,000 in preferred stock and \$80,000,000 in common stock, a total of \$345,000,000, and this capitalization was based upon the assumption, or one might say fiction, that the property then had a value of \$345,000,000. No provision was made in the Plan for the floating debt, which was considerable.

A committee of unsecured creditors sought to defeat the foreclosure suit upon the ground that it was the result of a conspiracy between bondholders and stockholders to exclude the floating debt and to turn over the valuable equity in the property to the stockholders. This effort was unsuccessful, the Circuit Court holding that the assets were insufficient to pay the mortgage debt and the net earnings insufficient to pay the fixed charges and that there was no equity in the property out of which unsecured creditors could be paid and that there was no reason why the mortgage bondholders in purchasing the property at foreclosure sale should not make any arrangements they chose for the participation of the old stockholders in the ownership of the stock of the reorganized company.¹ No appeal was taken from this decision.

The property was bought in at foreclosure sale by the bondholders' committee for \$61,500,000, which was \$86,000,000 less than the secured debts. It was transferred immediately to a new corporation which issued the \$345,000,000 of securities contemplated by the Plan, and the old stockholders, most of

¹ *Paton v. Northern Pacific Ry. Co.*, 85 Fed. 838; 1896.

whom paid the assessment, became the owners of the bulk of the stock of the new company.

About ten years after the consummation of this reorganization, the new Northern Pacific Company having in the meantime become highly prosperous, Boyd, the owner of a judgment for an unsecured claim against the old company, brought a suit against the old company and the new company, seeking to subject the property acquired by the latter from the former at foreclosure sale to the payment of his judgment. He claimed that the foreclosure sale was invalid because it was made in pursuance of a Plan of Reorganization between bondholders and stockholders of the railroad company which made no provision for the payment of the unsecured creditors, although the stockholders retained their interest by receiving shares in the new Company. The Court below sustained this contention and entered a decree making Boyd's claim a lien upon the property of the old company in the hands of the new company but subject to the mortgages placed thereon at the time of the reorganization. The Supreme Court, by a vote of five to four, affirmed the judgment, the dissenters being Chief Justice White and Justices Lurton, Holmes and Van Devanter.

The opinion of the majority of the Court proceeds upon the theory that while the bondholders might have lawfully bought in the property covered by the mortgage and kept it for themselves to the exclusion of both the unsecured debt and the stockholders, the moment they provided for participation in the new company by the stockholders, even at the price of paying a heavy assessment, the obligation arose to make provision for the unsecured debt which would recognize its priority to the interest of the stockholders.

The prevailing opinion says (p. 504) :

"The property was a trust fund charged primarily with the payment of corporate liabilities. Any device, whether by private contract or judicial sale under consent decree, whereby stockholders were preferred before the creditor was invalid. Being bound for the debts,

the purchase of their property, by their new company, for their benefit, put the stockholders in the position of a mortgagor buying at his own sale. . . . That such a sale would be void, even in the absence of fraud in the decree, appears from the reasoning in *Louisville Trust Company v. Louisville Ry.*, 174 U. S. 674, 683, 684 (the Monon case) where 'assuming that foreclosure proceedings may be carried on to some extent at least in the interests and for the benefit of both mortgagee and mortgagor (that is, bondholder and stockholder)' the court said that 'no such proceedings can be rightfully carried to consummation which recognize and preserve any interest in the stockholders without also recognizing and preserving the interests, not merely of the mortgagee, but of every creditor of the corporation. . . . Any arrangement of the parties by which the subordinate rights and interests of the stockholders are attempted to be secured at the expense of the prior rights of either class of creditors comes within judicial denunciation.'

The Court then says (p. 507) :

"The invalidity of the sale flowed from the character of the reorganization agreement regardless of the value of the property, for in cases like this, the question must be decided according to a fixed principle, not leaving the rights of the creditors to depend upon the balancing of evidence as to whether on the day of sale the property was insufficient to pay prior encumbrances."

The Court continues (p. 508) :

"This conclusion does not, as claimed, require the impossible and make it necessary to pay an unsecured creditor in cash as a condition of stockholders retaining an interest in the reorganized company. His interest can be preserved by the issuance, on equitable terms, of income bonds or preferred stock. If he declines a fair offer he is left to protect himself as any other creditor of a judgment debtor, and, having refused to come into a just reorganization, could not thereafter be heard in a court of equity to attack it."

This is the one hint which the Court vouchsafes as to the procedure which should be adopted in providing for unsecured debts under Plans of Reorganization based on the foreclosure of a mortgage but offering participation to stockholders.

Mr. Justice Lurton was right when he said in his dissenting opinion, that "The consequences which may result from the decision to the numerous reorganizations of railroad companies which occurred about the time of this reorganization or since, are to my mind alarming."

The result of this decision has been to introduce the greatest uncertainty and confusion in the reorganizations which have since been attempted and those which are now pending. It has materially reduced the opportunities for stockholders to participate in reorganizations controlled by mortgage bondholders, for, manifestly, the simplest way for a committee of mortgage bondholders to avoid the embarrassments of the *Boyd*¹ case is completely to exclude the stockholders and thereby gain freedom to exclude the unsecured debt. But still, in most large reorganizations, the stockholders knock loudly at the door for participation, and it is still the preference of most bondholders' committees to afford them participation, partly to avoid the dissatisfaction, litigation and delay which might result from their exclusion, and partly to secure new capital by appealing to the desire of stockholders to retain their interest in the property and their consequent willingness to furnish new capital on more favorable terms than could be obtained from strangers.

Naturally bondholders' committees are usually unwilling to admit stockholders upon a basis which will involve the payment of the unsecured creditors in cash. Therefore some offer of securities meeting the requirements of the *Boyd*¹ case must be made. This consideration is of special importance in several pending reorganizations of large magnitude, where the parent company is liable as guarantor of the obligations or contracts of subsidiary or affiliated companies the properties of which are to be excluded from the reorganization. In such cases there may be an enormous unsecured contingent liability which will be represented by no value whatever in the reorganized

¹ See *ante*.

property. The decision in the *Boyd*¹ case gives to the holders of these guaranteed obligations or contracts a position of unwarranted strength. They can say to the committee representing the bondholders of the parent corporation, unless you settle with us, we will assert our rights under the *Boyd*¹ case and practically force you to exclude your stockholders from the reorganization and thereby deprive you of the opportunity of raising your new capital by assessing them. In some cases the difficulty has been met by an agreement with the holder of the large unsecured claims, but in other cases counsel must form a conclusion as to what provision for the unsecured debt will meet the requirements of the *Boyd*¹ case.

It will be remembered that in the *Boyd*¹ case the Court said that the decision does not "make it necessary to pay an unsecured creditor in cash as a condition of stockholders retaining an interest in the reorganized company," that "his interest can be preserved by the issuance, on equitable terms, of income bonds or preferred stock," and that "if he declines a fair offer . . . and having refused to come into a just reorganization, he could not thereafter be heard in a court of equity to attack it." This, you will observe, is a very vague guide. It would seem reasonably clear that the opinion would be met by offering the unsecured creditor par in income bonds or preferred stock which would be prior to all the securities of the new company appropriated for the old stockholders, but in the ordinary case the old stockholders' participation is conditioned upon his paying a cash assessment for which he will receive a preferred security that would naturally rank ahead of the preferred stock or income bonds appropriated for the unsecured creditors. The opinion says he must be offered income bonds or preferred stock "on equitable terms." Does that mean that they may be offered at less than par? I am sure that no one can tell. Apparently the opinion leaves it for the court to determine in

¹ See *ante*.

each case whether or not the terms offered to the floating debt are equitable.

Mr. Joline, in his lecture of six years ago, said that

"The opinion of Justice Brewer in the Monon case stands . . . upon the pages of the reports, a dangerous weapon in the hands of guerrillas who hang about the outskirts of reorganizations and endeavor to levy tribute as a condition of abating the nuisance of their presence, and that even to this day, reorganizers stand in more or less terror of the Monon¹ case, and it looms up as a perpetual spectre in their path."

If this were true of the Monon¹ case, may we not say that the specter of six years ago has now become materialized into a veritable demon incarnate standing across the path of the reorganizer to-day? It must earnestly be hoped that before long the Supreme Court will have an opportunity of handing down a decision which will supplement its decision in the *Boyd* case by indicating some fixed principles to be applied in making provision for the floating debt in reorganizations based upon the foreclosure of mortgages which offer participation to stockholders.

The *Boyd*² case has been construed by the Federal Courts in several adjudicated cases, but none of them are of material aid.³ It had been the hope of the Bar that in the case of the *Kansas City Southern Railway Company v. Guardian Trust Company, et al.*, argued at the October Term, the Supreme Court would hand down a decision limiting the doctrine of the *Boyd*⁴ case or at all events laying down rules which would serve as a guide to counsel, but to their disappointment the opinion of Mr. Justice Holmes, handed down last week, concurred in by all of

¹ See *ante*.

² *Ibid*.

³ *Keech v. Stowe-Fuller Co.*, 205 Fed. 887; 1913; *Mechanics & Metals Nat. Bank v. Howell*, 207 Fed. 973; 1913; *Central Improvement Co. v. Cambria Steel Co.*, 210 Fed. 696; 1913; *Investment Registry v. Chicago & M. E. R. Co.*, 212 Fed. 594; 1913; *In re Howell*, 215 Fed. 1; 1914; *Equitable Tr. Co. v. United Box Board & Paper Co.*, 220 Fed. 714; 1915; *Western Union Tel. Co. v. U. S. & Mexican Trust Co.*, 221 Fed. 545; 1915.

⁴ See *ante*.

his associates excepting the Chief Justice and Mr. Justice Van Devanter, seems only to add to the uncertainty. In that case there was a bondholders' reorganization based upon the foreclosure of their mortgage. Although the Plan reserved a certain amount of cash for the payment of the floating debt — which turned out to be very largely in excess of that amount, — it did not definitely provide that the floating debt should all be paid but left it to the Reorganization Committee to determine whether and to what extent the cash so reserved should be used for that purpose. The Reorganization Committee paid a large number of the floating debt creditors, but not the complainant. The Court held that the provision in the Plan for the floating debt was inadequate, and that inasmuch as the Plan had admitted the stockholders, the New Company was liable for the debt of the complainant. The only new light shed by this decision is in the suggestion that if, in a given case, floating debt creditors are to be preferred to stockholders "it is essential to inquire whether the appellant (the New Company) . . . got by the foreclosure more than enough to satisfy the mortgage, which was a paramount lien." In the *Boyd*¹ case the Court, on the contrary, said that "the invalidity of the sale flowed from the character of the reorganization agreement regardless of the value of the property, . . ." and later in the opinion it seemed to assume that, whatever may have been the actual value of the property, the New Company was concluded by the estimate of value upon which its issue of new securities was based. The recent decision accordingly affords some hope that mortgage bondholders could carry through a Plan of Reorganization which admitted the stock and excluded the floating debt provided it could be shown that the value of the property did not exceed the mortgage lien, and provided also, possibly, that the new securities were based upon a valuation of the property which did not exceed that amount.

¹ See *ante*.

The Underwriting and Syndicate Agreements

Having completed the Plan and Agreement of Reorganization, the next important paper is the underwriting agreement. The parties to that are usually the reorganization committee or the reorganization managers on the one hand and the underwriting Syndicate or, more frequently, the Syndicate managers, on the other hand. It may be a very simple contract. Not infrequently an underwriting agreement creating an obligation running into tens of millions is expressed in a letter less than a page long. The agreement should refer to the Plan and Agreement of Reorganization, and provide that the Syndicate or Syndicate Managers shall, for a designated commission, agree to purchase such of the securities offered to the security holders whose participation is underwritten as shall not be subscribed for by them, paying therefor the amount of the so-called assessment and receiving all of the securities which would have gone to the non-assenting security holders had they joined in the Plan.

If your client, the bankers, happens to be the Syndicate Manager, it will also be your duty to draw the syndicate agreement, that is, the agreement between the Syndicate Managers and the participants in the Syndicate. This agreement also is sometimes embodied in a short letter, addressed by the Syndicate Managers to each participant and accepted by him, but more frequently, particularly in the case of large syndicates with numerous participants, a more formal instrument is employed. Such an agreement confers upon the Syndicate Managers power to bind the participants within the limit of the maximum syndicate obligation. It should provide that the liability of the Syndicate's subscribers shall be several and not joint and that the securities acquired for syndicate account may remain for a designated period under the control and management of the Syndicate Managers and sometimes, but not always, with the privilege to participants to withdraw

their securities from sale. The agreement should confer broad powers upon the Syndicate Managers to take such action in their discretion as they shall deem to be advantageous in the interest of the Syndicate. It is wise to provide that the Syndicate participations shall not be transferable except with the permission of the Syndicate Managers.

Consummation of the Plan

The Plan and Agreement of Reorganization having been adopted and signed on behalf of the committees and filed with the depositary, you next publish, in such newspapers and at such intervals as are designated in the Protective Agreement, the notice of the filing of the Plan, affording to depositors the privilege of withdrawing their securities in case they are dissatisfied with the Plan and to holders of undeposited securities the opportunity of depositing their securities under the Plan. The time for such additional deposits may be extended from time to time, with or without the payment of a penalty, until the Committee is satisfied that a sufficient proportion of the various classes of securities has been deposited to justify it in declaring the Plan operative. Its action in declaring the Plan operative usually consists of resolutions adopted, or an instrument signed, by its members which is filed with the depositary, and of notice given by publication as provided in the Agreement. Even after the Plan has been declared operative, further opportunity for the deposit of securities may be, and usually is, offered.

It is usually wise to advise your client to adopt a liberal policy in accepting deposits of securities and to avoid forcing minorities to fight by excluding them from participation in the Plan, however undeserving they may seem to be. The underwriting agreement and the syndicate agreement should clearly provide that, with or without the consent of the Syndicate Managers, preferably without, the Reorganization Committee

may permit delinquent security holders to participate in the Plan even after the date when under the terms of the underwriting agreement the Syndicate becomes entitled to receive the securities which would have gone to the non-assenting security holders had they participated in the Plan. Without such a provision, the rights of the Syndicate in respect of these securities would become fixed and the Reorganization Committee, and even the Syndicate Managers, would be powerless to appropriate any of the securities to the delinquent depositors.

The action of the Committee in declaring the Plan *operative* does not mean that the Plan has been executed, or even that it *can* be executed immediately. It simply means that the Syndicate is bound and that the Committee has determined to proceed with its effort to carry the Plan into execution. Even after the Plan has been declared operative, it may be modified or abandoned by action taken pursuant to the agreement. Reorganizations cannot be carried through over night. It usually takes from one to three years from the date of default to carry an important railroad system through reorganization. At the time that the Plan is declared operative your trustee may not have procured the foreclosure decree and almost certainly the foreclosure sale will not have taken place. It is very desirable that you should have obtained your foreclosure decree before the adoption of the Plan because then there will be much less opportunity for obstruction and less basis for a court holding, as it was held in the *Boyd*¹ case, that the decree was *in effect* a consent decree, inasmuch as the stockholders, by agreeing in advance to a Plan of Reorganization, had lost all incentive to oppose the entry of the decree. Much can be said in favor of the view that the doctrine of the *Boyd*¹ decision would not apply to a case where bondholders had obtained their decree without the assistance of stockholders, particularly if it had been obtained in the face of their active opposition.

¹ See *ante*.

An important problem in connection with the entry of the foreclosure decree is the fixing of the upset price. It should be sufficiently high not to be unfair to non-assenting bondholders but sufficiently low so that the distributive share of the proceeds of sale payable to the non-assenting bondholders is not so large as to impose a serious burden upon the reorganizers or encourage bondholders to refrain from participating in the Plan. If there is a large amount of junior debt not provided for in the Reorganization you will naturally be interested in keeping down the price to be paid for the mortgaged property in order that there may be as large a deficiency judgment as possible to share with the junior debt in the distribution of the unmortgaged assets. Reorganizations have sometimes been held up for months, even years, because the Court upon its own motion or at the instance of non-assenting bondholders, unsecured creditors or stockholders has fixed so high an upset price that the reorganizers were unwilling to provide the cash which would go to the non-assenting bondholders or others in case that upset price were paid. An effort to secure an inordinately high upset price is one of the favorite devices of those who seek to delay reorganizations either from good motives or bad.

You have now reached the stage when the professional obstructor is most likely to appear, if he has not already appeared. I was going to call him the professional striker, but that would hardly be fair, because the small security holder who seeks to obstruct a reorganization is not always a striker, by which I mean a person who seeks by creating a nuisance value for himself to force the payment of an amount wholly disproportionate to his interest in the property as the price of the withdrawal of the nuisance of his presence. There are a certain number of men who make it a profession to watch reorganizations and other large corporate transactions with a view to instituting litigation at some critical moment in the hope of creating a nuisance value for themselves. On the

other hand, among the thousands of security holders affected by an important reorganization there are very apt to be men who, through vanity, personal spite, stubbornness or mere fondness for opposition, are disposed to be diligent in hunting for an opportunity to oppose the plans of the majority and who have no ambition to be bought off. Opposition may come also from security holders who are sincerely opposed to the Plan from honorable motives.

Courts often seem inclined to favor small minorities upon the theory that for some reason they should be protected against the assumed oppression of the majority. Our own Court of Appeals has been particularly critical of reorganizations and diligent in protecting minorities.¹ My own observation leads me to the opinion that most cases of oppression in reorganizations are not cases where the majority seek to oppress the minority but where the minority become the oppressors by seeking to hold up or delay the plans of the majority. Plans of reorganization are usually fair and any plan must give all security holders of the same class an equal opportunity to participate. Most of the outcry against the unfairness of reorganizations comes from people who for selfish purposes seek an advantage out of proportion to their interest in the property.

If there is a weak place in your armor, some critic is very apt to find it out, and even where there is none, the amount of expense, trouble and delay which the holder of a small amount of securities may cause by vigorous litigation is astounding. If his motive is a corrupt one, he is very apt to enter the arena at the most critical stage of your plans when, perhaps because of favorable market conditions, your clients have chosen to launch their reorganization and when even a month's delay may bring failure although at the moment success seems assured. It may be that the underwriting syndicate is only

¹ See *United States Water Works Company, Limited v. The Omaha Water Co.*, 164 N. Y. 41; 1900, *ante*; *Industrial & Trust Co. v. Todd*, 180 N. Y. 215; 1905, *ante*; and *Cox v. Stokes*, 156 N. Y. 491; 1898.

bound for a limited period and that it will be released in case the action of the security holders is delayed beyond that period by injunction or otherwise. It may well be that although you feel certain of ultimate success in defeating it, the attack has been so timed that the mere delay involved in meeting it will imperil, if not defeat, your client's plans. You may find yourself in such a predicament, although you have taken every conceivable precaution to guard against it, and then you have to face the hardest problem with which counsel in reorganizations and large corporate transactions have to deal, and that is, shall you advise your client to fight or to settle. Your instinct will doubtless be to fight, but, fortunately for your peace of mind, when you have given your advice your client will probably take the decision into his own hands.

The Plan having been declared operative, you are in a position to determine whether the amounts of cash paid in by the assenting security holders are sufficient for the requirements of the purchase and the other cash requirements which must be met prior to the organization of the new company. If not, the Syndicate must be called upon to pay in the required amount of cash to be held subject to the order of the Committee.

At the foreclosure sale the bidder for the Committee is usually a subcommittee designated a "purchasing committee." The subcommittee must be armed with instructions from the Committee as to how high it shall bid in case there are rival bidders. Counsel who have acted frequently for reorganization committees have spent a great many anxious hours preparing for the unexpected bidder, but in my own experience he has never appeared. The reason for this, of course, is that the Committee can pay the major part of the purchase price by surrendering bonds, while a rival bidder, unless it be a rival bondholders' committee, must pay in cash. Manifestly in most sales where the security holders interested in the sale have combined and placed their interest in the hands of a

committee there is not likely to be serious competition at the sale. As a protection against bogus or holdup bids see to it that the decree requires a substantial deposit to qualify bidders.

In order to secure a reasonably prompt sale, it is often necessary to defer the determination of many questions relating to the relative priorities of claimants until the distribution of the proceeds of sale. Such a course may mean that the value at which your Committee's bonds will be received in payment of the purchase price will be less than what you deem to be their ultimate interest in the distribution of the proceeds of sale. Usually this does not increase the amount of actual cash required to be paid by the Committee at the time of sale, because of the convenient practice of inserting in the decree a provision that even after the confirmation of the sale the court shall retain jurisdiction for the purpose of enforcing the payment of the purchase price. Courts are therefore lenient in permitting purchasing committees to take possession of the property even though there is a chance that it may be subsequently determined that further payments are required upon the purchase price.¹

Special care must be exercised that the sale is conducted fairly and in strict compliance with the decree and the published terms of sale and that no basis is offered for a successful attack upon the sale, particularly if there is a substantial amount of non-assenting bonds. It is well settled that the mere fact that the security holders have combined to bid at the sale is not a ground for setting it aside.² Courts are not disposed to set aside sales where there was a fair opportunity for outside bidders and no fraud or irregularity can be shown.

The sale having been confirmed by the Court, the Master is ready to deliver his deed, which may either be to the pur-

¹ *Short on Railway Bonds and Mortgages*, p. 733; 1897; *First National Bank of Cleveland v. Shedd*, 121 U. S. 74; 1887.

² *Robinson v. Iron Railway Co.*, 135 U. S. 522; 1890.

chasing committee, or, upon its order, to the new company which has been organized with authority to issue the securities contemplated by the Plan.

Having applied the proceeds of sale to your bonds, you should then see to the entry by the Trustee of the deficiency judgment which will participate with the unsecured debt in the distribution of the proceeds of the unmortgaged assets. The deficiency judgment is usually a relatively unimportant factor in railroad reorganizations because the amount of unmortgaged assets is generally small, but it is often highly important in the reorganization of an industrial corporation inasmuch as a very large proportion of its property, including current assets, is usually not covered by the mortgage.

One of the most important questions you have to decide is as to the State in which to incorporate the new company. If it is a railroad company you can usually choose any of the States through which its lines run. Your choice will be influenced by a great variety of considerations such as the relative liberality of the corporation laws of the various States and the powers and policy of their public service commissions. The latter consideration is especially important if the only securities to be issued by the new company are shares of stock, for probably in that case the only public service commission you will have to consult with will be that of the State of incorporation, but, as I have already pointed out, if the reorganization contemplates an issue of mortgage bonds, you will probably have to secure the approval of the mortgage by the public service commission of each State in which the lines to be mortgaged extend. In the case of railroad reorganizations, it is sometimes necessary to organize a separate corporation to hold the property in a particular State because the laws of that State forbid foreign corporations to acquire railroads within that State. As a rule, the separate corporations thus formed are ultimately consolidated and you then create that hydra-headed monster, a consolidated corporation of two or more

States. Many States, including New York,¹ provide special statutes for the organization of corporations to carry out reorganizations.

The Reorganization Committee not only causes the purchasing committee, or the Master, to deed the purchased property to the new company, but turns over to it all unpaid subscriptions for new securities and all the cash in its hands except such as it requires for its expenses. It is also usual to turn over to the new company all of the deposited securities to serve as muniments of title in case any question should subsequently develop as to the Company's title to the property acquired from the committee.

The new company, besides issuing to the Committee the new securities required by the Plan, should approve the Committee's compensation and expenses and assume its liabilities so that the Committee may be discharged of any further responsibility respecting the reorganization to others than its depositors.

The Committee should now publish notice that the new securities are ready for distribution and that each depositor may receive his share of the new securities upon surrendering to the depositary his certificate of deposit endorsed in blank and making the final payment on his assessment, if it has not already been paid in full.

It is desirable that definitive engraved certificates should be ready for distribution, and provision for this should be made well in advance as the engraving requires several weeks, sometimes several months. If the engraved certificates are not ready, temporary printed certificates exchangeable for engraved certificates may be distributed. Resort to temporary certificates should be avoided if possible, because of the additional trouble and expense involved in their issue and ultimate exchange for definitive certificates.

¹ Stock Corporation Law, Sec. 9 et seq. (*N. Y. Consolidated Laws*).

Voting Trusts

Voting trusts are usual to insure control for a period of time in persons chosen by the reorganizers so that there may be reasonable assurance of adherence to the policy contemplated by the reorganization. Ordinary questions, such as the election of directors, are usually left to the discretion of the Voting Trustees, but it is usual to provide that questions of a radical nature such as the sale of the property, the increase of the capital stock and the creation of a mortgage shall be submitted to the holders of the voting trust certificates for their approval or disapproval. There is not time to discuss the perplexing questions as to the limits within which voting trusts are lawful. Suffice it to say that it is usually possible to create, for a limited period, an effective voting trust of the stock issued in a reorganization. In New York voting trusts for a period not exceeding five years under certain limitations are expressly authorized by statute¹ and it is customary in reorganizations centering in New York to endeavor to comply with the terms of that statute.

General Remarks

In tracing the proceedings of the reorganization, I have, for the sake of simplicity and continuity, assumed that you have been acting as counsel for a Committee representing mortgage bonds whose position was such as to dominate, if not control, the reorganization. The problems presented would be somewhat different if you were acting as counsel for unsecured creditors or for mortgage bondholders not in a dominant or controlling position, or for committees representing preferred or common stock.

When the Plan has been executed, that is, when your committee has received the new securities and cash, and not until then, I am sorry to say, the time has come for the Committee

¹ General Corporation Law, Sec. 25 (*N. Y. Consolidated Laws*).

to pay your fee and also to pay its own compensation and that of the depositaries and the other agents which have been employed in the course of the reorganization. I know not why, but although committees are willing to use the funds under their control or even to borrow money upon the pledge of the deposited securities for almost every other purpose, from time immemorial it has been the custom for counsel not to receive or even ask for their fees until the reorganization has been consummated or abandoned. That is one reason why the fees paid to counsel in reorganizations are popularly supposed to be much higher than they really are. A fee of \$100,000 to counsel upon the consummation of a successful reorganization may seem high to one who does not realize that it is compensation for two or even three or four years of perhaps the hardest work and the gravest responsibility which fall to a lawyer's lot and that there are few departments of professional activity where experience, familiarity with established practices, office organization and equipment and willingness to work under pressure without regard to personal convenience, count for so much.

READJUSTMENT OF THE DEBT OR SHARE CAPITAL OF CORPORATIONS BECAUSE OF INSOLVENCY OR FINANCIAL NEEDS OF SOME SORT WHERE THE PROPERTY IS NOT TRANSFERRED TO A NEW CORPORATION

In these cases it is usually necessary to start, as in the case of the other class of reorganizations, with committees and deposit agreements calling for the deposit of the various classes of securities to be dealt with, because, in order to carry through a voluntary readjustment, it is necessary that the power to deal with the securities shall be concentrated in a few hands. Manifestly, if A holds the entire capital stock of a company, and B holds its entire issue of mortgage bonds, and C holds its entire floating debt, those three men could, by acting together, make practically any rearrangement of the capitalization they

chose, providing no rule of law was violated. In practice it is necessary that just this kind of control should be brought about by the deposit of the outstanding securities with one or more committees. Sometimes deposits are invited before a Plan of Readjustment has been formulated, and in that event there must be provision for the promulgation of a Plan, and in most cases there should also be provision, such as we have already discussed in connection with reorganizations, for affording to depositors an opportunity to reject the Plan and withdraw their securities. Sometimes a Plan of Readjustment is announced at the outset and deposits of securities under that particular Plan are invited.

In the case of corporations having large issues of widely scattered securities, it is often necessary that the Plan and Agreement should be so drawn that, if the readjustment cannot be affected by the voluntary action of the security holders, it may, without a further grant of power from the depositors, be effected by mortgage foreclosure or other enforcement of the rights of security holders.

A voluntary readjustment may be preceded by a receivership, or even by the institution of foreclosure proceedings, for in case the necessary support of security holders eventually is forthcoming, the receivership can be dismissed, or the foreclosure suit abandoned. Very frequently, a receivership or foreclosure suit furnishes the only effective means of convincing the security holders of a corporation that its position is such that coöperation in a voluntary reorganization is essential to avert the loss and expense incident to foreclosure sale or liquidation. The very complex reorganization of The Baltimore and Ohio Railroad Company in 1899 was finally carried through as a voluntary reorganization, although foreclosure suits had been instituted and the property was in the hands of receivers for over three years. The widely scattered securities finally came in with practical unanimity so that old mortgages and old stock issues were canceled, new bond issues and new

stock issues were created, the old securities were exchanged for the new, and thus the whole financial structure of the corporation was reconstructed.

The same result was accomplished in the reorganization of the Texas and Pacific Company in 1887, where the foreclosure sale actually took place but was never confirmed. The consent of the security holders finally made it possible to cancel the old mortgages, dismiss the foreclosure proceedings, create new mortgages and issue additional stock, thereby preserving the corporation's Federal charter.

A more recent and somewhat remarkable instance of a successful voluntary readjustment is that of the Hudson & Manhattan Railroad Company, the owner of the so-called Hudson Tubes connecting New York with New Jersey, which was carried through in 1913. This company found its earnings insufficient to pay the interest upon its \$67,000,000 of mortgage bonds which were outstanding and widely scattered. Under a plan for the voluntary readjustment of its debt, under which three banking firms acted as Readjustment Managers, and without court proceedings of any kind, it succeeded in securing the surrender of practically its entire bond issue in exchange for new first mortgage bonds and new income bonds, half and half, and also secured the payment of a cash assessment of about \$3,800,000 from the stockholders, for which they received new first mortgage bonds.

Voluntary reorganizations are, however, comparatively infrequent in the case of railroad companies. The business of a railroad company is not apt to suffer seriously from a receivership. Indeed a railroad often emerges from foreclosure and receivership materially strengthened by the purging process through which it has passed. Not so with the average industrial corporation, whose business, goodwill and trade position are apt to be shattered by the effects of even the most successful receivership or the most expeditious foreclosure. While in the case of a railroad, liquidation is usually impossible, if the

affairs of an insolvent industrial corporation once get into the courts there is always the danger that creditors will force liquidation, preferring the cash proceeds of liquidation to the securities of a reorganized company. Consequently sensible men, in dealing with an insolvent industrial corporation, make every effort to accomplish a voluntary readjustment, and the consequences of failure are so serious to the security holders that their cooperation is much more likely to be forthcoming than in the case of an insolvent railroad.

As I have already said, the purpose of an agreement providing for the voluntary readjustment of the capital and debt of a corporation is to concentrate the securities in one hand or in a few hands, so that the necessary changes can readily be accomplished. It is rarely possible, however, in the case of a corporation with considerable amounts of widely scattered securities to secure literal unanimity. The Readjustment Agreement should, therefore, provide that the Committee or the Readjustment Managers shall have discretion to determine when the deposited securities are sufficient in amount to justify the consummation of the readjustment, even though it results in preferential treatment for the security holders who do not assent to the Plan. For instance, if the holders of 90 per cent. of the bonds assent to the Plan, it may be necessary to use part of the cash produced by the assessment paid by the assenting security holders to pay the non-assenting bonds in full. In other cases it may be necessary to grant, in effect, a preference to non-assenting stock. Except in the comparatively rare case of redeemable preferred stock, there is usually no way in a voluntary readjustment by which the status of stock can be changed without the consent of its holders, so that it becomes necessary in such a case to continue the non-assenting stock without disturbing its status except so far as may be permitted by the exercise of the powers expressly conferred by the corporation's charter or by the statutes subject to which the corporation was organized. In all these cases the reorganizers must determine

whether the expense and practical injustice involved in thus preferring the non-assenting securities is more than counter-balanced by the advantages to the assenting securities which will accrue from a successful consummation of the readjustment without the expense and loss incident to foreclosure or liquidation.

A receivership in the Federal courts, such as we considered in discussing reorganizations, is usually the most serviceable means of preserving the property pending an effort to carry through a voluntary readjustment. When an agreement has been reached with the holders of the entire overdue debt or of so much of it that the balance can be paid from the cash which has accumulated in the hands of the receiver or which is provided by the assessment upon the assenting security holders, the receivership can be lifted and the property restored to the corporation, which automatically becomes solvent again. It must be remembered, however, that a receivership proceeding based upon a creditor's bill is a proceeding for the benefit of *all* creditors, and is beyond the control of the immediate parties to the suit, with the result that the receivership cannot be terminated unless the court is satisfied that the Company will be solvent and that all the creditors holding overdue claims have assented or that adequate provision has been made for the payment of all non-assenting claims.

Courts of equity, particularly the Federal courts, will go very far and exercise very wide powers in protecting the property and business of an industrial corporation where there appears to be a reasonable prospect of carrying through a readjustment. They will authorize their receivers to continue the business in the regular way, to extend the usual credits to customers, to borrow money, to carry on extensive manufacturing operations, to improve manufacturing plants, to enter into contracts involving large commitments running over considerable periods of time, and to protect the assets against foreclosure proceedings by paying interest on the mortgage debt. There is no such latitude and elasticity in statutory receiverships in any

State with which I am familiar, although, as now conducted by the courts, bankruptcy proceedings for industrial corporations are by no means hopeless. As I have already explained in the case of industrial corporations, an equity receivership is no assurance against bankruptcy proceedings, and a threat to institute bankruptcy proceedings is a common weapon of the creditor who seeks to create a nuisance value for himself at the expense of those who are endeavoring to effect a readjustment.

In dealing with creditors in voluntary readjustments, the principles which must guide you are comparatively simple. If the creditors' claims are overdue, you are at their mercy and you must either pay them or induce them to accept some security in satisfaction of their claims. This of course is wholly a matter of agreement. It is in dealing with stock, and with the rights of stockholders, that the most difficult and perplexing questions are apt to arise.

In issuing stock you must never forget that the corporation must get something for it and in most States it must get par value in money or in money's worth. As the stock of a corporation which is in financial difficulty usually sells much below par, its unissued stock, or to speak more accurately, its capacity to issue additional stock, is not apt to be of much use, for not even the unanimous consent of stockholders will, as against creditors, legalize the issue of stock which is not fully paid.¹

Therefore, in voluntary readjustments of corporations in financial straits, you are usually compelled to resort to one or both of two devices, if you intend to raise money by the sale of stock. The first is to create preferred stock, which, by reason of its preference, may be salable at par. The second is to secure the surrender of stock already outstanding, which being already fully paid, can be sold at any fair price that the company may fix.² I might add a third device, namely, that of

¹ *Goodnow v. American Writing Paper Co.*, 72 N. J. Eq. 645; 1907, *aff'd*, 73 N. J. Eq. 692.

² *Lake Superior Iron Co. v. Drexel* (1882), 90 N. Y. 87; 1882; *Williams v. Taylor*, 120 N. Y. 244; 1890.

selling obligations at a large discount, accompanied by the sale of stock at par,¹ but there are difficulties in the way of this device which usually render it of little practical value.

The statutes of many of the States expressly provide for the creation of preferred stock by the vote of a certain proportion of the existing stock, and in such a case, if the necessary vote can be secured, it is perfectly simple to create preferred stock which will take precedence both as to assets and dividends over common stock, or, in some cases, a new preferred stock which will take precedence over preferred stock already existing. If you can thus create preferred stock and sell it at par, the problem is simple.

Usually where the statutes of a State do not specifically authorize preferred stock it can be created by contract between the stockholders under the doctrine of the decision of our Court of Appeals in the case of *Kent v. Quicksilver Mining Co.*,² but in the case of a voluntary readjustment based upon this principle it is necessary to secure the consent of the holders of all the outstanding stock unless you are willing, and your agreement permits, that the rights of the non-assenting minority in assets and dividends should not be disturbed by the creation of the new preferred stock.

In dealing with preferred stock already outstanding, you can usually do very little without the unanimous consent of the stock affected. Without that consent you cannot increase or decrease the rate of dividends³ or impair the stockholders' right to arrears of dividends⁴ but can sometimes, as I have said, create a prior preferred stock.

Manifestly the second of the expedients I have suggested is the one which is most useful and it is the one most frequently resorted to, that is, securing the surrender of outstanding stock which, being fully paid, may be disposed of for any fair con-

¹ See *Gamble v. Queens Co. Water Co.*, 123 N. Y. 91; 1890.

² 78 N. Y. 159; 1879.

³ *Pronick v. Spirits Distributing Co.*, 58 N. J. Eq. 97; 1899.

⁴ *Colgate v. United States Leather Co.*, 73 N. J. Eq. 72; 1907.

sideration without regard to its par value. Such stock, when surrendered by the stockholders, can be disposed of by the corporation itself or by a readjustment committee, can be sold at any fair price to raise cash, can be given as a bonus with the sale of unissued stock at par or with a sale of obligations at their fair market value, can be given to stockholders in return for a cash assessment, and can be used in almost any other way that happens to fit the requirements of the case. It may also be placed in the treasury of the company for subsequent sale.

Voluntary readjustments of capital stock may sometimes be accomplished by the sale of the corporation's property as an entirety under statutes or charter provisions permitting such sales with the consent of a certain proportion of its stockholders. Such statutes and charter provisions, however, are usually not of great practical value in the readjustment of the capital of corporations in financial distress, because provision must be made for the payment of creditors, and also because in most States the sale of the entire property of a corporation is not valid against dissenting stockholders if the purchase price is payable in new securities or otherwise than in cash; and finally, because of the difficulties towards non-assenting stockholders due to the fact that necessarily the majority interests are both purchasers and sellers. In the case of a corporation in financial straits having both common stock and preferred stock which is preferred as to assets as well as dividends, it is usually out of the question to effect a readjustment by this means without the unanimous action of the preferred stock, because the preferred stockholders are entitled to the proceeds of sale, up to the par value of their stock plus arrears in dividends, before provision can be made for the common stock.

There is an interesting group of problems which have often been presented, and are apt to be presented again, in connection with industrial corporations of the kind which were organized in great numbers fifteen or twenty years ago with an issue

of cumulative preferred stock, usually preferred both as to assets and dividends, and an issue of common stock, representing the organizer's hopes for the future. In many instances the hopes which were thus capitalized in common stock were not realized so that eventually the corporation finds itself in this predicament: There is a large arrears of dividends upon its preferred stock. It may be perfectly solvent in the sense that its assets are ample for the payment of its debts, and it may be earning substantial profits. These, however, must be applied in payment of the arrears of dividends upon the preferred stock before any dividend can be declared upon the common stock. But the common stock, which may equal or exceed in amount the preferred stock, has voting control and elects the directors. By reason of the accumulation of dividends upon the preferred stock the prospect for dividends upon the common stock is so remote that the directors who represent the common stock are apt to forget that the chief purpose of a business corporation is to pay dividends. The natural result of such an unsatisfactory situation is an effort to recapitalize on a basis which will more nearly represent the value and earning capacity of the property and provide fairly for both the preferred and common shares. It may well be that the aggregate value of the enterprise is less than the par value of the preferred stock and its accumulated arrears of dividends. This naturally prompts the preferred stockholders to feel that they own the property and should give nothing on recapitalization to the common stock. The common stockholders, on the other hand, may say: We control the corporation through our power to elect the directors and we will not surrender our position unless we are recognized in the readjustment. These conflicting views have, in many cases, resulted in a deadlock which still exists and which, perhaps, some of you may be called upon to break.

Certain stockholders of the United States Leather Company tried to meet such a situation in 1905 by organizing the Central

Leather Company which acquired a large majority of the preferred stock and common stock of the old company. An attempt was then made to merge the old company into the new upon the basis of exchanging the old preferred stock for bonds, preferred stock and common stock of the new company. Here we find the inherent embarrassment, incident to any merger of this character, that the same interests control both the merging and merged company and the merger is simply a means of carrying out a prearranged plan which will have the effect of disturbing the relative positions of the preferred and common shareholders of the old company. The New Jersey Court of Errors and Appeals held the merger invalid upon the ground that the old preferred shareholders had a vested interest in the arrears of dividends which could not be destroyed without their consent.¹ This decision left the Central Leather Company as the owner of the preponderating majority of common and preferred stock of the United States Leather Company, which continued for several years as the operating company, paying dividends to the holding company, which in turn distributed this income by way of dividends upon its own shares. Ultimately the old company was successfully merged into the new company, presumably after the latter had acquired by purchase all the shares of the old company.

A somewhat different method of meeting the same problem was adopted by the American Malt Corporation. This corporation was organized in 1897, with approximately \$15,000,000 of cumulative preferred stock and \$15,000,000 of common stock. In 1906 it found itself entirely solvent but its earnings were insufficient to pay the current dividends on its preferred stock, to say nothing of the forty-five and one-half per cent accumulated arrears of dividends. A new corporation called the American Malt Corporation was formed under the laws of New Jersey with an authorized capital stock of \$9,000,000 of preferred and \$6,000,000 of common stock. It offered to

¹ *Colgate v. United States Leather Co.*, *ante*.

acquire the outstanding common and preferred shares of the old company on the basis of \$62 in new preferred stock for each share of old preferred stock, including arrears of dividends, and \$44 in new common stock for each share of old common stock. Under this plan, a full dividend paid by the old company upon its preferred stock would provide the new company with an income sufficient to pay the full dividend upon the new preferred stock and a substantial dividend upon the new common stock. Before very long over ninety per cent of each class of the old stock had been acquired, and the new company continued as the holding company and the old company as the operating company. Gradually additional amounts of the old stock were exchanged until in 1913 the new company had acquired over ninety-eight per cent of the old stock. Then an attempt was made to merge the old company into the new, but this plan was defeated by the refusal of the Board of Public Utility Commissioners of New Jersey to approve the merger. Their refusal was based on the grounds, first, that the businesses of the two corporations were not similar in character within the meaning of the Corporation Act permitting merger, as one was a manufacturing company and the other a holding company; and second, that the property did not justify the proposed capitalization of \$15,000,000 and therefore involved an issue of stock at less than par; and third, that the plan was unfair to the preferred stockholders. The Supreme Court of New Jersey upheld the action of the Board upon the last two grounds and this decision was sustained by the Court of Errors and Appeals.¹ I understand that the plan was then dropped and that no attempt has since been made to complete the readjustment.

I cannot furnish a more instructive illustration of the application of several of the principles to be applied in voluntary readjustments of capitalization than by briefly describing

¹ *American Malt Corporation v. Board of Public Utility Commissioners*, 92 Atl. 362; 1914.

three successive voluntary readjustments of the capital and debt of a certain well-known and now highly prosperous industrial corporation.¹

This company was organized in 1885 with a comparatively small capital. I shall pass over its first recapitalization five years later when the enterprise, by the unanimous action of its stockholders, was transferred from the original company to a new company having a larger capital and a special charter conferring very broad powers. There were successive increases in the authorized capital of the company and in 1891 it had outstanding about \$7,000,000 of common stock out of an authorized issue of \$10,000,000. Having incurred a large floating debt, it found itself in embarrassed circumstances, and in order to meet the situation the following readjustment was adopted :

The company, by an appropriate vote of its stockholders, authorized \$4,000,000 of preferred stock. It had, however, only \$3,000,000 of unissued stock and accordingly it asked its stockholders to surrender forty per cent. of their holdings, and in order to encourage this surrender it was provided that the remaining sixty per cent. of the stock retained by the assenting stockholders should be called "assenting stock" and should become a second preferred stock entitled to dividends in preference to the common stock held by those who declined to turn in the forty per cent. of their holdings. The holders of all the common stock except about six thousand shares joined in the Plan (years later all came in) so that the Company, besides its \$3,000,000 of unissued stock, had \$2,600,000 of full-paid stock surrendered by stockholders. One million dollars of this latter stock, together with the \$3,000,000 of unissued stock, was used to make up the \$4,000,000 of preferred stock, and the balance, \$1,600,000, remained in the treasury as "as-

¹ The Westinghouse Electric & Manufacturing Company. For a study of its principal readjustment, see Dewing, *Corporate Promotions and Reorganizations* (Harvard Economic Studies, Vol. X), p. 165.

senting" or second preferred stock. The corporation therefore had \$4,000,000 of first preferred stock and \$1,500,000 of second preferred stock, all of which was fully paid except the \$3,000,000 of unissued preferred stock, so that the entire block of stock could have been sold for \$3,000,000. As a matter of fact, it was sold on a much more favorable basis than that, and the crisis was successfully met.

The Company prospered and grew, indeed it grew too rapidly for its capital, for by 1907 it was confronted with a financial crisis more grave than the one of fifteen years before. By this time it had outstanding, roughly, the following securities :

Preferred Stock	\$ 4,000,000
Assenting and non-assenting common stock, about . . .	25,000,000
Five per cent. Convertible Bonds	18,500,000
Other obligations, chiefly floating debt	16,500,000

The Company found itself unable to meet its maturing floating debt and accordingly, upon a creditor's bill and the usual answer of the Company, receivers were appointed by the Federal District Courts.

A bondholders' protective committee was formed which prepared a Plan of Reorganization, to which it is unnecessary to refer, as it was never carried into effect. The receivers were able to continue the business very efficiently under the liberal orders of the Federal courts, and they were even authorized to pay the maturing interest upon the bonds, thereby preventing a default upon the bonds and an acceleration of their maturity by the Trustee. A so-called "Merchandise Creditors' Committee" carried through a Plan whereby the merchandise creditors took new common stock at par in payment for claims aggregating about \$4,000,000, the stockholders paid a cash assessment aggregating about \$6,000,000, receiving therefor new common stock at par, and bank creditors to the amount of some \$8,000,000 were paid in part by long-time obligations and in part by stock at par. The convertible bonds were not

disturbed. Thus the holders of the greater part of the floating debt agreed to take new securities and sufficient cash was provided to pay the balance of the floating debt and provide working capital. Thereupon the Company filed a petition in each of the United States District Courts in which Receivers had been appointed, setting forth the facts and, after allowing time for creditors to be heard and being satisfied that upon the consummation of the Plan the Company would be solvent and that provision had been made for all of its overdue debts, each Court entered an order discharging the Receivers. This in many ways is the most remarkable voluntary readjustment of capital with which I am familiar.

With the added strength resulting from this readjustment, the Company again prospered and grew until it reached another crisis brought on by prosperity. The agreement securing its convertible bonds limited the purposes for which they could be issued, precluded the incurring of other debt beyond a certain limit which had almost been reached as a result of increased business, and placed limitations upon the issue of common stock with which it would have been difficult to comply even if additional common stock could have been marketed, which was not the case, as its market price was below par. The redemption of the convertible bonds and the creation of a new issue of bonds would have been a most expensive operation, inasmuch as they were selling several points below par and could be redeemed only at a premium of five per cent above par, and of course the cost of selling a new issue of securities would be considerable. This is an excellent illustration of a prosperous and thoroughly solvent corporation requiring readjustment because defects in its financial structure prevented it from securing additional capital required for the development of its business.

When the prosperity resulting from the European war sent the common stock of the Company above par, the Board of Directors authorized a new issue of convertible bonds precisely

like the old ones, except that they were convertible into new stock *at par* instead of at a premium of one hundred per cent, as was the case with the original issue, and were secured by a trust indenture which omitted certain restrictive covenants contained in the trust indenture securing the old bonds. The Company then offered to the holders of the old bonds the privilege of exchanging them for the new bonds or for cash or for part cash and part new bonds, subject to the prior offering to the stockholders of the privilege of subscribing for the new convertible bonds. The sale of the new bonds was underwritten by a banking syndicate. The net result of this last readjustment was the retirement of the old bonds and the substitution of the new bonds and, I may add, the ultimate conversion of the greater part of the latter into common stock at par. As a result of this series of voluntary readjustments there is now a corporation, practically out of debt, with an issued capital stock of about \$4,000,000 of preferred and \$37,000,000 of common stock. No one can estimate how different the result might have been if at either one of the two earlier crises the forbearance of creditors and the faith of stockholders had not made it possible to avoid a reorganization based upon foreclosure or other enforcement of the claims of creditors.

I think I have said enough to suggest the infinite variety and complexity of the questions which are likely to arise in efforts for the voluntary readjustment of the capital and debt of corporations with large amounts of securities in the hands of widely scattered holders. There is no department of practice in which there is a greater opportunity for ingenuity, resourcefulness and originality on the part of counsel, and for courage, patience and wisdom on the part of security holders, directors and officers of corporations.

THE RECAPITALIZATION OF CORPORATIONS FOR SOME OTHER
PURPOSE THAN TO MEET INSOLVENCY OR CORRECT
DEFECTS OF FINANCIAL STRUCTURE AND WHICH MAY BE
ACCOMPLISHED EITHER WITH OR WITHOUT THE TRANSFER
OF THE PROPERTY TO A NEW CORPORATION

Here again the objects sought to be accomplished and the methods employed are so varied that few rules can be laid down. I can do little more than suggest examples.

There is however one underlying principle which it is useful to have in mind and that is, that under the decisions of the United States Supreme Court, the Court of Appeals of New York and the courts of most of the States, any readjustment of the capitalization of a corporation which is agreed upon by the holders of all the stock is binding upon the corporation and all subsequent holders of the stock issued upon such recapitalization. In other words, leaving out of consideration the rights of creditors, any such readjustment is permanently effective if agreed upon by all the owners of the property at the time.

The rule is well stated by our Court of Appeals in *Seymour v. The Spring Forest Cemetery Association*.¹ In speaking of a transaction where the owners of property sold it at a price alleged to be greatly in excess of its value to a corporation which the vendors controlled and of which they were the only stockholders, Judge Finch said (p. 340) :

"The sellers were the buyers. They sold as individuals and bought as a corporation, and no one else had any interest in the question of price or terms of sale. If they were the vendors on the one hand, dealing with themselves in a corporate capacity on the other, they were also the sole beneficiaries to be affected and could not defraud themselves. The abstraction of the corporate entity should never be allowed to bar out and pervert the real and obvious truth. As beneficiaries, the stockholders necessarily assented to all the details of the arrangement, and no just criticism is possible either upon the legality or morality of the transaction." ²

¹ 144 N. Y. 333; 1895. ² See also *Blum v. Whitney*, 185 N. Y. 232; 1906.

I think that practically all the authorities agree that such a transaction as I have described is binding not only upon the original holders of the stock but also upon subsequent holders of that stock.¹ The same result follows in the case of bonds. Where an issue of bonds is assented to by the corporation and all of its stockholders neither the original takers of the bonds nor subsequent holders of the assenting stock can question the legality of the issue.²

The case of *Mayer v. Metropolitan Traction Company*³ is an excellent illustration of the extent to which this doctrine has been carried. In that case, the owner of a railroad of insignificant value organized a corporation to which it transferred the railroad in exchange for \$1,500,000 of bonds and \$1,500,000 of stock. The bonds were guaranteed by their owner, a strong corporation, which eventually sold them to investors and pocketed the proceeds of sale, not a dollar of which was spent on the mortgaged property. Years later when the guarantor corporation became insolvent and the mortgaged property was found to be almost worthless, the investors who held the bonds sought through their receiver to enforce a claim against the original owner of the bonds, which organized the corporation and received its bonds and stock in payment for the property transferred. This seemed like a hard case, but the Appellate Division of the Supreme Court for the First Department found that no legal wrong had been committed, saying in their opinion (p. 503):

¹ Cases *supra* and *Barr v. New York, Lake Erie and Western Railroad Company*, 125 N. Y. 263; 1891; *Parsons v. Hayes*, 14 Abb. N. C. (N. Y.) 419; 1883; *Bostwick v. Young*, 118 App. Div. 490; 1907; *aff'd*, 194 N. Y. 516; 1909; *In re Syracuse etc. R. R. Co.*, 91 N. Y. 1; 1883; *Kent v. Quicksilver Mining Co.*, 78 N. Y. 159; 1879.

² *Belden v. Burke*, 147 N. Y. 542; 1895; *Mayer v. Metropolitan Traction Company*, 165 App. Div. 497; 1914; *Seymour v. Spring Forest Cemetery Association, supra*; *Tompkins v. Sperry, Jones & Co.*, 54 Atl. 254 (Md.); 1903; *The Columbus Hocking Valley etc. Ry. Co. v. Lanier* (N. Y. Sup. Ct. 1893), 8 N. Y. Law Jour. No. 104 (Feb. 4, 1893); *Old Dominion Copper Mining and Smelting Co. v. Bigelow*, 188 Mass. 315, 325; 1905; *Mason v. Carrothers*, 74 Atl. 1030 (Me.); 1909.

³ 165 App. Div. 497; 1914.

“ . . . the vendor and vendee could lawfully put any price upon the property which they chose, and if the price was agreed upon by all persons interested as directors and stockholders in the vendee company, as it appears to have been in this case, neither that company nor anyone suing in its right can question the transaction on the ground that the price was too high.”

When we come to consider the effect of such a transaction upon the holders, not of the original issue of stock, but of stock subsequently issued, we find the courts divided. The most interesting instance of this is furnished by the Old Dominion Copper Company litigation, in which the Supreme Court of the United States and the Supreme Court of Massachusetts reached diametrically opposite conclusions upon precisely the same state of facts. In that case, Bigelow, Lewisohn and their associates organized a mining company of which they became the sole stockholders and of which the board of directors was composed of themselves and their nominees. They sold to the corporation certain mining property which they owned, in return for an amount of stock greatly in excess of the value of the property. Then, without any disclosure of the profit which they were making, they caused the corporation to sell to the public for cash an additional amount of stock for working capital. Several years later, the corporation brought suit against Bigelow in Massachusetts in the State court and against Lewisohn in New York in the Federal Court to rescind the sale or for an accounting or damages. The Supreme Court of Massachusetts held that the corporation was entitled to recover upon the theory that Bigelow and Lewisohn, being promoters, were bound to make disclosure of their profit and that their own knowledge “was not equivalent to a disclosure to the plaintiff corporation, although they owned all the stock of the plaintiff corporation outstanding at the time the sale was made.” The Court seems to have assumed that subsequent purchasers of the particular stock originally issued to Lewisohn and Bigelow, would be “bound by the acquiescence of their

vendors" and that the corporation would have been bound had the transaction been "acquiesced in not only by all those interested but by all those" who, it was contemplated, should "be interested in the corporation, except as third persons should acquire the interest of some one or more of those persons." The Court, however, found a cause of action in the corporation because of the subsequent issue of stock to subscribers to whom no disclosure of the promoters' profit had been made, particularly as such subsequent issue was contemplated at the time of the original transaction.¹

The Circuit Court of Appeals for the Second Circuit in the suit against Lewisohn reached precisely the opposite conclusion and its decision was affirmed by the Supreme Court of the United States.² The opinion of Mr. Justice Holmes proceeded upon the theory that at the time of the original transaction "there was no wrong done to any one. Bigelow, Lewisohn and their syndicate were on both sides of the bargain, and they might issue to themselves as much stock in their corporation as they liked in exchange for their conveyance of their land," and that the assent originally given by all the stockholders bound the corporation for all time inasmuch as its identity was not changed by the subsequent addition of new members, for, as Justice Holmes tersely said, "a corporation does not change its identity by adding a cubit to its stature."

After the decision in the United States Supreme Court, Bigelow endeavored to secure a rehearing of his case by the Massachusetts Supreme Court, but this was refused, and in the end Bigelow or his estate was compelled to pay under the decision of the Supreme Court of Massachusetts while Lewisohn went scot free under the decision of the Supreme Court of the United States.

The question involved in the Old Dominion Copper Company³ litigation subsequently came before the Supreme Court

¹ *Old Dominion Copper, etc., Co. v. Bigelow*, 188 Mass. 315; 1905.

² *Ibid.*, *Lewisohn*, 210 U. S. 206; 1908.

³ See *ante*.

of Maine in *Mason v. Carrothers*.¹ That court followed the Supreme Court of Massachusetts and refused to follow the Supreme Court of the United States. It attempted, however, to distinguish the case before it upon the ground that the suit was brought, not by the corporation, but by the stockholders who purchased stock from the treasury of the corporation, and it construed the opinion of the Supreme Court of the United States as intimating that subsequent purchasers of stock from the corporation might have the right to maintain an action because they were the parties who were wronged. This construction is erroneous because the kind of action which the Supreme Court had in mind in the intimation referred to was an action by the purchasers of the stock for deceit, while in the case before the Supreme Court of Maine the suit was by stockholders to compel the holders of the stock under attack to surrender it to the corporation for cancellation.

I have discussed thus fully the doctrines of the *Old Dominion Copper cases*, *Blum v. Whitney* and similar cases, because they come up so frequently in cases of voluntary recapitalization.

I will now give a few examples of recapitalization.

A corporation which has accumulated a large surplus frequently wishes to distribute among its stockholders some security to represent this accumulation. Often stock to a par amount not exceeding the surplus is distributed among the stockholders. This is called a stock dividend. In this country, bonds or other obligations may also be issued for this purpose² in the absence of a statute to the contrary.³

If a corporation with a large surplus whose stock is selling substantially above par, wishes to accomplish the double

¹ 74 Atl. 1030; 1909.

² *Wood v. Lary*, 47 Hun. 550; N. Y. 1888; *aff'd*, 124 N. Y. 83; 1891; *Billingham v. Gleason Mfg. Co.*, 91 N. Y. Supp. 1046; 1905; *Barnard v. Vermont etc. R. R. Co.*, 7 Allen (Mass.) 512; 1863. See also *Bailey v. R. R. Co.*, 22 Wall. (U. S.), 604; 1874. As to England see *Wood v. Odessa Waterworks Co.* (1889), 42 Ch. Div. 636; *Hoole v. Great Western Ry. Co.* (1867), 3 Ch. App. 262.

³ See *Delaware General Corp. Law*, par. 35, as amended by Laws 1911, Chap. 188, Secs. 1 and 2.

purpose of practically distributing a stock dividend and at the same time securing additional capital, it may offer stock to its stockholders for *pro rata* subscription at a price below the actual value of the stock, but of course not less than par. Such an offer does not necessarily place upon the stockholder the burden of actually subscribing for his *pro rata* share of the new stock, because his right to subscribe is usually evidenced by a transferable warrant which should be saleable on a basis which represents approximately the difference between the subscription price and the market value of the stock which he is entitled to purchase.

Except in the case of a corporation having a charter which expressly provides for the sale of stock without first offering it to stockholders, new stock (as distinguished from stock which has already been issued and has been acquired by the corporation as treasury stock) must always be offered for *pro rata* subscription to the stockholders before it is sold to others.¹ Even where the charter contains such a provision, the new stock should be offered to stockholders before it is sold to others at less than its fair market price.

Perhaps the most frequent case of recapitalization is where the stock of a corporation has been closely held during the period of development and does not represent the actual value of the property, and the owners for some reason, usually for the purpose of creating a market for their securities, desire a capitalization based upon the actual value and earning capacity of the enterprise and more nearly in scale with the capitalization of other similar enterprises. Here the problem is quite simple if the assent of the entire outstanding capital stock can be procured. Either of two methods may then be used. One method is to authorize the new securities to such an amount as the value of the property will justify and then issue them *pro rata* to the holders of the old stock as a dividend. Under the doctrine of *Old Dominion Copper Company v. Lewisohn*, and *Blum*

¹ *Stokes v. Continental Trust Co.*, 186 N. Y. 285; 1906.

v. *Whitney* (*supra*), there can be no objection to the securities thus issued inasmuch as all the stockholders have agreed to their issue, it being assumed that the rights of creditors are not impaired.

The other method, and the one usually adopted, is to organize a new corporation with authority to issue the required amount of securities and cause it to acquire the business and property of the old corporation, issuing in payment its own securities in the required amount, which are received by the old company and distributed among its stockholders after provision has been made for creditors, which is usually done by the new company assuming the debts of the old company.

In some States it is possible to issue obligations to retire preferred stock. A very interesting application of this device was made by the United States Steel Corporation in 1902 when it issued \$200,000,000 of Five Per Cent. Bonds to provide for the retirement of an equal amount of Seven Per Cent. Preferred Stock. This transaction was upheld by the New Jersey Court of Errors and Appeals in *Berger v. United States Steel Corporation*.¹

A very convenient method of accomplishing the practical recapitalization of an enterprise where the entire capital stock is not under control is by means of the so-called holding company. The holding company is a comparatively modern device. It was the law in most of the States until a few years ago, that a corporation had no power to hold the stocks of other corporations. The general power to do so was not conferred by statute in New York until the enactment of Chapter 688 of the Laws of 1892.² It was conferred a few years earlier in New Jersey.³ In some States, as in Illinois,⁴ and

¹ 63 N. J. Eq. 809; 1902.

² See Laws 1890, Chap. 564, Sec. 40, and Laws 1850, Chap. 140, Sec. 8.

³ In 1889.

⁴ Act of June 11, 1897, Sec. 1; Ill. Stat. Annot. 1913, par. 8748; Laws Ill. 1913, p. 475.

Missouri¹ it has never been conferred except to a limited extent in the case of certain classes of corporations.

I have already called attention to one of the frequent uses of the holding company in the recapitalization of industrial corporations having outstanding preferred stock with large arrears of dividends, as in the case of the Central Leather Company and the American Malt Corporation. It is frequently resorted to where the unanimous action of stockholders cannot be procured at the outset and as a means of accomplishing the ultimate direct recapitalization of one or more underlying enterprises. An interesting illustration of this is furnished by the history of the Metropolitan Traction Company, which was a holding company, pure and simple, organized to acquire the capital of, and ultimately consolidate, various street railway corporations operating street surface railroads in New York City. Gradually the entire capital stock of all of the important underlying companies was acquired and by means of consolidations and mergers they were welded into one railroad corporation, called the Metropolitan Street Railway Company, all of the capital stock of which was owned by the Metropolitan Traction Company as the holding company. The latter then went into voluntary liquidation and distributed the stock of the Metropolitan Street Railway Company among its stockholders. The holding company having thus accomplished its mission was dissolved. The Brooklyn Rapid Transit Company was organized for a similar purpose and is still a holding company, pure and simple.

In the last few years the organization of holding companies has become less fashionable than formerly, both because of restrictive Federal and State legislation and because of their unpopularity, due partly to the misfortunes of certain ill-conceived holding companies and the extent to which they were organized in carrying through consolidations which, although

¹ Rev. Stat. (1909), §§ 3316, 3329, 3443.

deemed lawful at the time of their organization, were subsequently held to have been organized in violation of the Federal Anti-trust Laws. The enactment of the so-called "Seven Sisters" by the Legislature of New Jersey in 1913¹ has practically put an end to the organization of holding companies in New Jersey except within very narrow limits, and Section 7 of the Clayton Act² enacted by Congress in 1914 provides that

"No corporation shall acquire, directly or indirectly, the whole or any part of the stock or other share capital of two or more corporations engaged in commerce where the effect of such acquisition, or the use of such stock by the voting or granting of proxies or otherwise, may be to substantially lessen competition between such corporations, or any of them, whose stock or other share capital is so acquired, or to restrain such commerce in any section or community, or tend to create a monopoly of any line of commerce."

No discussion of the practical aspects of voluntary recapitalization would be complete without a reference to the strange form of organization commonly known as a "Massachusetts Trust," which seems to have found its origin in the fact that the Massachusetts statutes did not permit the organization of a corporation to hold land. In Massachusetts the rule against perpetuities apparently is satisfied if all rights vest during any number of lives in being, which may be those of complete strangers to the trust. Although in *Windsor v. Mills*³ there is a dictum to the effect that the permissible period of restraint on alienations should be assimilated to that of the rule against perpetuities, no limitation upon restrictions on alienation of equitable estates has yet been made.⁴ The practical result of this is that if it is so stipulated in a deed of trust, there will not, as in New York and elsewhere, be a merger of the legal and equitable estates, even though the entire present equitable

¹ Laws 1913, Chaps. 13, 14, 15, 16, 17, 18 and 19.

² U. S. Stat. 1914, Chap. 321.

³ 157 Mass. 362; 1892.

⁴ *Southard v. Southard*, 210 Mass. 347; 1911.

estate and the entire future legal estate are vested in the same person.¹ In Massachusetts there is also another rule, not generally current, that a provision in a partnership agreement that partnership interests may be freely sold without terminating the partnership, is valid and effective.²

Under these favoring laws the custom has grown up in Massachusetts of depositing shares of one or more corporations with trustees under declarations of trust, which provide for the use of a name like that of a corporation, the issue of freely vendable certificates of interest or shares, with or without par value, the election of directors, and many other attributes of a corporation. These organizations fall roughly into two classes, those which are strict trusts and those which I may call partnership trusts. In the strict trust the certificate holders are not personally liable for the organization's debts, but they apparently have no right of control over the business unless it be that certain things may not be done without their consent. In the partnership trust the estate is usually handled by the trustees under the direction of the certificate holders or of a committee appointed by them, which may or may not include the trustees, and in this case the partners may, depending on the particular form of the transaction, be held liable for the organization's debts.³

While these trusts are sometimes created to operate enterprises, they are more frequently used to accomplish the same purpose as holding companies in cases where for some reason it is not wise to organize a holding company.

There are a considerable number of organizations of this character which are doubtless generally assumed to be cor-

¹ *Broadway National Bank v. Adams*, 133 Mass. 170; 1882; and subsequent cases citing it.

² *Phillips v. Blatchford*, 137 Mass. 510; 1884; *Williams v. Milton*, 215 Mass. 1; 1913.

³ *Mayo v. Moritz*, 151 Mass. 481; 1890; *Hussey v. Arnold*, 185 Mass. 202; 1904; *Williams v. Milton*, 215 Mass. 1; 1913; *Frost v. Thompson*, 219 Mass. 360; 1914; *Howe v. Morse*, 174 Mass. 491; 1899.

porations. The Mackay Companies, the Massachusetts Gas Companies, and the Chicago Elevated Railways, Unincorporated, are conspicuous examples.¹

¹ The Massachusetts statutes relating to these trusts are Chapter 441 of 1909, as amended by Chapter 454 of 1913 and Chapter 471 of 1914, and Chapters 509 and 596 of 1913.

Chapter 596 of 1913 provides for annual publication by the Massachusetts State commissioner of corporations of the trust agreements on file in his office. Copies of this publication are easily to be had and contain a variety of precedents.

S. R. Wrightington's *Unincorporated Associations*, Boston, 1916, in addition to much valuable information on the subject generally, has an appendix which contains a number of precedents, some of which have been passed upon by the Massachusetts courts.

Other books and articles on the subject are: J. H. Sears's *Trust Estates as Business Companies*, St. Louis, 1912; A. D. Chandler's *Express Trusts under the Common Law*, Boston, 1912, and an article by Mr. Wrightington in the *Yale Law Journal* for February, 1912.

THE SHERMAN ANTI-TRUST LAW

A Lecture Delivered before the Association of the Bar of the City of New York
by George W. Wickersham, March 15, 1916

SENATOR GEORGE F. HOAR, of Massachusetts, in a eulogy of John Sherman, delivered in the United States Senate after the death of the latter, said:¹

"It is a little singular that the two great measures that are called by his name are measures, one of which he disapproved, and with the other of which he had nothing to do. I mean the bill for the purchase of silver, known as the Sherman Law, and the bill in regard to trusts, known as the Sherman Antitrust Law. The former was adopted against his protest by a committee of conference, although he gave it a reluctant and disgusted support at the end. . . . The other, known as the Sherman Antitrust Bill, I suppose he introduced by request. I doubt very much whether he read it. If he did, I do not think he ever understood it. It was totally reconstructed in the Judiciary Committee."

This statement was probably the origin of the impression, widely disseminated in the community at a later date when the true meaning and effect of the Sherman Law began to be understood and felt, that the bill had been framed in haste and passed in ignorance of its meaning, with a confused idea of its effect. Nothing could be more remote from the actual facts, and Senator Hoar's statement furnishes another example of the effect of time upon the memory of even acute-minded and able men.

Senator Sherman's original bill was introduced in the Senate on August 14, 1888. It was entitled, "A bill to declare unlawful trusts and combinations in restraint of trade and production." It provided that "all arrangements, contracts, agree-

¹ Autobiography of Seventy Years, Vol. II, p. 22.

ments, trusts, or combinations between persons or corporations, made with a view, or which tend, to prevent full and free competition in the production, manufacture, or sale of articles of domestic growth or production, or of the sale of articles imported into the United States, and all arrangements, contracts, agreements, trusts, or combinations between persons or corporations designed, or which tend, to advance the cost to the consumer of any of such articles, are hereby declared to be against public policy, unlawful and void; . . .”

A right of action was given to any person injured by any such agreement, etc., and it was declared that any corporation doing business within the United States which took part in any such arrangement should forfeit its corporate franchise.

The bill was referred to the Finance Committee, was reported with certain amendments a month later, was briefly debated in the following January, again recommitted and re-reported with further amendments, upon which there was further debate, during which Senator George, of Mississippi, subjected the measure to severe criticism and demonstrated that it was beyond the constitutional power of Congress to enact, because it did not attempt to regulate commerce among the States, but only transactions which antedated that commerce. This was during the short session of Congress. During the same session, fourteen bills relating to the same subject were introduced into the House of Representatives, where they were the subject of some discussion. At the following session, in December, 1889, the first bill introduced in the Senate was Senator Sherman's amended bill (S. 1), bearing the same title as that introduced by him at the previous session, but modified to meet the criticisms that had been made of it during the debates. It was referred to the Committee on Finance, and on January 14, 1890, was reported back with amendments. It was debated from time to time during the entire session, some of the ablest members of the Senate taking part in the discussions. Senators Cullom, Ingalls, Allison, Dawes, Teller, Reagan, Hoar,

Spooner, Gray, Gorman and Wilson, besides the introducer of the bill, engaged in the debate. These debates took a wide range and their record fills upwards of 220 pages of the Congressional Record. At an early stage in the discussions, Mr. Sherman in a carefully prepared speech explained the objects of his bill:

"It declares," he said, "that certain contracts are against public policy, null and void. It does not announce a new principle of law, but applies old and well recognized principles of the common law to the complicated jurisdiction of our State and Federal Government. Similar contracts in any State in the Union are now, by common or statute law, null and void. Each State can and does prevent and control combinations within the limit of the State. This we do not propose to interfere with. The power of the State courts has been repeatedly exercised to set aside such combinations, as I shall hereafter show, but these courts are limited in their jurisdiction to the State, and, in our complex system of government, are admitted to be unable to deal with the great evil that now threatens us.

"Unlawful combinations, unlawful at common law, now extend to all the States and interfere with our foreign and domestic commerce and with the importation and sale of goods subject to duty under the laws of the United States, against which only the general government can secure relief. They not only affect our commerce with foreign nations, but trade and transportation among the several States. The purpose of this bill is to enable the courts of the United States to apply the same remedies against combinations which injuriously affect the interests of the United States that have been applied in the several States to protect local interests."

It is important to note this statement at the outset, because through all the varying forms which the bill took until its final enactment, the end sought by the lawmakers was always that thus expressed by Senator Sherman. Continuing his argument, he made another statement, which so clearly expresses the evil against which the legislation was directed, that I may perhaps be pardoned if I reproduce it here in full, as furnishing a clear description of that mischief which the old Federal law was powerless to remedy, and to meet which the new law was de-

signed; thus following the time-honored rule laid down by Blackstone for the construction of statutes. Senator Sherman devoted some time to stating what his bill did not pretend to accomplish. He said it did not interfere with any lawful business in the United States, whether conducted by a corporation or a partnership or an individual. It dealt, he said :

“Only with unlawful combinations, unlawful by the code of any law of any civilized nation of ancient or modern times.”

“But,” he continued, “associated enterprise and capital are not satisfied with partnerships and corporations competing with each other, and have invented a new form of combination, commonly called trusts, that seeks to avoid competition by combining the controlling corporations, partnerships and individuals engaged in the same business, and placing the power and property of the combination under the government of a few individuals, and often under the control of a single man called a trustee, a chairman or a president.

“The sole object of such a combination is to make competition impossible. It can control the market, raise or lower prices, as will best promote its selfish interests, reduce prices in a particular locality and break down competition and advance prices at will where competition does not exist. Its governing motive is to increase the profits of the parties composing it. The law of selfishness, uncontrolled by competition, compels it to disregard the interest of the consumer. It dictates terms to transportation companies, it commands the price of labor without fear of strikes, for in its field it allows no competitors. Such a combination is far more dangerous than any heretofore invented, and, when it embraces the great body of all the corporations engaged in a particular industry in all of the States of the Union, it tends to advance the price to the consumer of any article produced, it is a substantial monopoly injurious to the public, and, by the rule of both the common and the civil law, is null and void and the just subject of restraint by the courts, of forfeiture of corporate rights and privileges, and in some cases should be denounced as a crime, and the individuals engaged in it should be punished as criminals. It is this kind of a combination we have to deal with now.

“If the concentrated powers of this combination are intrusted to a single man, it is a kingly prerogative, inconsistent with our form of government, and should be subject to the strong resistance of the State and national authorities. If anything is wrong this is wrong. If we will not endure a king as a political power we should not endure

a king over the production, transportation and sale of any of the necessities of life. If we would not submit to an emperor we should not submit to an autocrat of trade, with power to prevent competition and to fix the price of any commodity. If the combination is confined to a State the State should apply the remedy; if it is interstate and controls any production in many States, Congress must apply the remedy."

As examples of the combination against which the legislation was directed, Senator Sherman referred to the Standard Oil combination, the Diamond Match Company, the Chicago Gas Company, the Sugar Trust, etc.

After a very extensive debate, in which a number of objections to the bill as framed were pointed out by different Senators, the bill was, on March 27, 1890, committed to the Committee on the Judiciary, from which, on April 2, it was reported back in substantially the same form in which it was later enacted. It was debated on April 2 and April 8, during which Senator Hoar, Chairman of the Judiciary Committee, reiterated his statement that,

"The great thing that this bill does, except affording a remedy, is to extend the common-law principles, which protected fair competition in trade in old times in England, to international and interstate commerce in the United States."

On April 8, 1890, the bill was passed by the Senate by a vote of 52 to 1. It came up for consideration in the House of Representatives on May 1, 1890, in the form in which it passed the Senate, and was debated on that and on subsequent days. It was passed in a somewhat different form from the Senate bill, went to conference, and after disagreement and report to each house upon the disagreement, it was again referred back, debated, recommitted, re-referred, and finally, on June 20, 1890, the House accepted the bill as it had passed the Senate. On July 2, 1890, it was signed by the President.

As so enacted, the act, which is entitled, "An Act to protect trade and commerce against unlawful restraints and monop-

lies," contains eight sections. The first declares to be illegal "every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade, or commerce among the several States, or with foreign nations," and every person who shall make any such contract or engage in any such combination or conspiracy, to be guilty of a misdemeanor and liable to fine and imprisonment. The second section provides that "Every person who shall monopolize, or attempt to monopolize, or combine, or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States or with foreign nations, shall be deemed guilty of a misdemeanor," and liable to fine and imprisonment. By the fourth section, the several Circuit Courts of the United States are invested with jurisdiction "to prevent and restrain violations of this act," and it is made the duty of the several district attorneys, under the direction of the Attorney-General, to institute proceedings in equity to prevent and restrain such violations. By the seventh section, a right of action is given to any person who shall be injured in his interests or property by any other person or corporation by reason of anything forbidden or declared to be unlawful by the act, to sue therefore in any Circuit Court of the United States in the district in which the defendant may reside or be found, without respect to the amount in controversy, and to recover threefold the damages sustained by him and the costs of suit, including a reasonable attorney's fee.

Shortly after the passage of this act, a petition was filed by the United States in the Circuit Court at Philadelphia, attacking certain contracts made by one Searles on behalf of the American Sugar Refining Company for the purchase of four separate refineries in the City of Philadelphia, by which contracts, it was alleged, the American Sugar Refining Company secured control of 96 per cent of all the manufactories of sugar in the United States. The bill prayed for the rescission of these contracts. District Judge Butler, in dismissing the bill, said :

"The contracts and acts of the defendants relate exclusively to the acquisition of sugar refineries and the business of sugar refining in Pennsylvania. They have no reference and bear no relation to commerce between the States or with foreign nations. . . . It is the stream of commerce flowing across the States and between them and foreign nations that Congress is authorized to regulate. To prevent direct interference with, or disturbance of, this flow alone was the power granted to the Federal Government."

Upon this finding of fact, the bill was dismissed, and on appeal, the Supreme Court, Justice Harlan alone dissenting, approved the action of the trial judge, and treating the whole question to be whether, conceding that the execution of these contracts and the conveyance to the American Sugar Refining Company pursuant thereto of the four refineries embraced therein, would give the Sugar Company a monopoly in manufacture, held that a monopoly of such manufacture could not be directly suppressed under the act of Congress in the mode attempted by the bill, because, while the power to control the manufacture of a given thing involves in a certain sense the control of its disposition, this is a secondary and not a primary sense, for although the exercise of that power might result in bringing the operation of commerce into play, it did not control it, but affected it only incidentally and indirectly. There was nothing in the proofs, said Chief Justice Fuller, in writing the opinion of the court,

"to indicate any intention to put a restraint upon trade or commerce, and the fact, as we have seen, that trade or commerce might be indirectly affected was not enough to entitle complainants to a decree. The subject matter of the sale was shares of manufacturing stock, and the relief sought was the surrender of property which had already passed and the suppression of the alleged monopoly in manufacture by the restoration of the *status quo* before the transfers."¹

Justice Harlan based his dissent upon a broader inference from the facts, contending that the acts of the defendant must

¹ 156 U. S. 17, 34; 1895.

be regarded as indicating a distinct intention to monopolize interstate trade and commerce in sugar.

"It may be admitted," he said, "that an act which did nothing more than forbid, and which had no other object than to forbid, the mere refining of sugar in any State, would be in excess of any power granted to Congress. But the act of 1890 is not of that character. It does not strike at the manufacture simply of articles that are legitimate or recognized subjects of commerce, but at combinations that unduly restrain, because they monopolize, the buying and selling of articles which are to go into interstate commerce."

He summed up the discussion in these words :

"Whatever improperly obstructs the free course of interstate intercourse and trade, as involved in the buying and selling of articles to be carried from one State to another, may be reached by Congress, under its authority to regulate commerce among the States. The exercise of that authority so as to make trade among the States, in all recognized articles of commerce, absolutely free from unreasonable or illegal restrictions imposed by combinations, is justified by an express grant of power to Congress and would redound to the welfare of the whole country. I am unable to perceive that any such result would imperil the autonomy of the States, especially as that result cannot be attained through the action of any one State.

"Undue restrictions or burdens upon the purchasing of goods in the market for sale, to be transported to other States, cannot be imposed even by a State without violating the freedom of commercial intercourse guaranteed by the Constitution. But if a State within whose limits the business of refining sugar is exclusively carried on may not constitutionally impose burdens upon purchases of sugar to be transported to other States, how comes it that combinations of corporations or individuals, within the same State, may not be prevented by the national government from putting unlawful restraints upon the purchasing of that article to be carried from the State in which such purchases are made?"¹

Justice Harlan's dissenting opinion has finally become the law of the court, but, for the time, the application of the law received a severe setback by this decision and the views of

¹ 156 U. S. 37, 38; 1895.

the statute entertained by the other Justices as expressed by Chief Justice Fuller.

Attorney General Harmon reported to Congress, in 1895, that neither combinations nor monopolies could be reached under the Sherman Act "simply because they are combinations and monopolies, nor because they may engage in interstate commerce as one of the incidents of their business" and, in the following year, he told Congress that the restricted scope of the provisions of the Act, as they had been construed in the *Knight Case*, "makes amendment necessary if any effective action is expected of this department."¹

In March, 1897, the Supreme Court, in the *Trans-Missouri Freight Association Case*,² held the act to be applicable to railroad companies and that it made illegal a traffic association by which free competition between competing railroads was prevented; a decision which was reiterated in the *Joint Traffic Association Case*³ a year later. In each of those cases the opinion was written by Mr. Justice Peckham and expressed a construction of the law which, while not required by the facts of the cases before the court, yet gave rise to a school of literal construction of the act which was wholly destructive of the original intent of its framers and in effect amounted to a *reductio ad absurdum* of the statute, because it converted a measure intended to prevent unlawful restraints upon commerce into an act to forbid the ordinary contracts essential to any healthy conduct of commerce. This construction was squarely repudiated by the Supreme Court when it was presented in the *Standard Oil*⁴ and *Tobacco Cases*.⁵ But long before them, in February, 1898, the Circuit Court in the Sixth Circuit, composed of Justice Harlan and Judges Lurton and Taft, the latter writing the opinion, gave an application to the act which in some measure removed the blight upon its effectiveness resulting from the *Knight Case*, by holding it applicable to a com-

¹ Attorney Gen. Rep. (U. S.), 1896, p. xxvii.

² 166 U. S. 290; 1897.

³ 171 U. S. 505; 1898.

⁴ 221 U. S. 1; 1911.

⁵ *Ibid.*, 106; 1911.

bination of corporations manufacturing iron pipe in different States, whereby the freedom of competition among them in the manufacture and sale of that commodity among a number of Southern States was suppressed. Judge Taft's analysis and history of the English Law relating to unreasonable restraints of trade is one of the most exhaustive and accurate summaries of the subject to be found in the books. His analysis of the *Knight Case*¹ restricted the application of that decision substantially as it was subsequently restricted by the Supreme Court.

"It seems to us clear," he said, "that, from the beginning to the end of the opinion, the Chief Justice draws the distinction between a restraint upon the business of manufacturing and a restraint upon the trade or commerce between the States in the articles after manufacture, with the manifest purpose of showing that the regulating power of Congress under the Constitution could affect only the latter, while the former was not under Federal control, and rested wholly with the States. . . . The subject matter of the restraint here was not articles of merchandise or their manufacture, but contracts for sale of such articles to be delivered across State lines, and the negotiations and bids preliminary to the making of such contracts, all of which, as we have seen, do not merely affect interstate commerce, but are interstate commerce. It can hardly be said that a combination in restraint of what is interstate commerce does not directly affect and burden that commerce. The error into which the Circuit Court fell, it seems to us, was in not observing the difference between the regulating power of Congress over contracts and negotiations for sales of goods to be delivered across State lines, and that over the merchandise, the subject of such sales and negotiations. The goods are not within the control of Congress until they are in actual transit from one State to another. But the negotiations and making of sales which necessarily involve in their execution the delivery of merchandise across State lines are interstate commerce, and so within the regulating power of Congress even before the transit of the goods in performance of the contract has begun."

This decision was unanimously affirmed by the Supreme Court,² Justice Peckham writing the opinion, in which he

¹ 85 Fed. 297; 1898.

² 175 U. S. 225; 1899.

stated that the court was of the opinion that the direct effect of the agreement or combination under consideration was to regulate interstate commerce, and, therefore, that the case was not covered by the decision in *United States v. Knight*.¹

"The direct purpose of the combination in the *Knight Case*," he said, "was the control of the manufacture of sugar. There was no combination or agreement, in terms, regarding the future disposition of the manufactured article; nothing looking to a transaction in the nature of interstate commerce. The probable intention on the part of the manufacturer of the sugar to thereafter dispose of it by sending it to some market in another State, was held to be immaterial and not to alter the character of the combination. The various cases which had been decided in this Court relating to the subject of interstate commerce, and to the difference between that and the manufacture of commodities, and also the police power of the States as affected by the commerce clause of the Constitution, were adverted to, and the case was decided upon the principle that a combination simply to control manufacture was not a violation of the act of Congress, because such a contract or combination did not directly control or affect interstate commerce, but that contracts for the sale and transportation to other States of specific articles were proper subjects for regulation because they did form part of such commerce."

On the other hand, he agreed with the court below that the combination of the pipe manufacturers did involve contracts of the nature last mentioned, not incidentally or collaterally, but as a direct and immediate result of the combination engaged in by the defendants.

The Court of Appeals in the Second Circuit, in December, 1908, in a suit brought by the Pennsylvania Sugar Refining Company against the American Sugar Refining Company and its directors, distinguished the *Knight Case* substantially as was done in the *Addyston Pipe Case*.² The complaint there alleged that the defendants conspired to prevent the plaintiff from reëngaging in the business of importing raw sugar from other states and foreign countries into the State of Pennsylvania, there manufacturing it into refined sugar, and exporting the

¹ 156 U. S. 1; 1895.

² 166 Fed. 254; 1908.

manufactured product to other States and countries, and that they accomplished their object by inducing one who indirectly held the controlling stock interest in the plaintiff corporation, to accept a loan of a large sum of money and turn over to them such interest with the voting power attached, which they exercised to elect new directors, whom they caused to vote that the plaintiff should do no business. The Court, speaking by Judge Noyes, said :

“A comparison of the *Knight Case* with the case at bar shows some striking superficial resemblances. Both related to actions of the American Sugar Refining Company in obtaining control of independent sugar refining companies in Philadelphia. But there is this fundamental distinction between them : The one was an agreement for the restriction of competition which related directly to manufacture and only indirectly to interstate commerce ; the other was a conspiracy to prevent a manufacturer from engaging in business which necessarily directly restrained interstate commerce. . . . The decision in the *Knight Case* was that upon the proofs the agreements there in question related to manufacture — to production — and were not in restraint of interstate commerce, although they may have affected such commerce incidentally and indirectly. But there was present in this case that which Mr. Chief Justice Fuller said was absent in the *Knight Case* :

“‘There was nothing in the proofs to indicate any intention to put a restraint upon trade or commerce, and the fact, as we have seen, that trade or commerce might be indirectly affected, was not enough to entitle complainants to a decree.’

* * * * *

“It must be clearly borne in mind that the defendants in this case are not charged simply with preventing the plaintiff from engaging in a manufacturing business. If they were, the *Knight decision* would undoubtedly be applicable. They are expressly charged also with preventing the plaintiff from engaging in interstate commerce — with preventing the importation of raw materials and the exportation of the manufactured product. . . . The purpose of the conspiracy in the present case was not only to obtain control of the plaintiff corporation and thus doubtless acquire a monopoly, but to exercise the power of control so obtained to wholly prevent the plaintiff from engaging in a business, the carrying on of which necessarily involved interstate commerce.”

The court held that the principles of the *Addyston Pipe Case*,¹ distinguishing the *Knight Case*, were directly applicable, and that, because the conspiracy charged in the complaint did not relate wholly to production within the State of Pennsylvania, the case was not controlled by the *Knight* decision.

It seems incredible that after the decision in the *Addyston Pipe Case*¹ anybody should have assumed that the decision of the *Knight Case* would protect from the operation of the Sherman Law any combination or agreement which directly suppressed competition between persons engaged in the manufacture and sale of merchandise among the several States, or that it could be relied upon to protect anything more than the very rare case of a combination between persons or corporations engaged wholly in manufacturing and selling within a single State. Nevertheless, those who wished to centralize control over manufactured products by various forms of agreement or corporate ownership clung to the *Knight Case* as the rock of their salvation, until the Chief Justice in the *Standard Oil* opinion forever disposed of it in a few brief words.

The next stage in the development of the Sherman Law was reached in April, 1903, when the United States Circuit Court in the Eighth Circuit, by the unanimous vote of all four Circuit Judges, held the act to be applicable to the Northern Securities Company, a New Jersey corporation which had acquired control of the stock of the Northern Pacific and the Great Northern Railway Companies, thereby placing it in the power of the Securities Company to suppress competition between those two competing and parallel lines of railroad engaged in interstate commerce; a decision which was affirmed by the Supreme Court in March, 1904,² by a bare majority of the Court. Justice Harlan wrote the principal opinion in support of the affirmance, and Justice Brewer filed an opinion which, while concurring with Justice Harlan in the result expressed, dissented from some of the reasoning of his opinion.

¹ See *supra*.

² 193 U. S. 197; 1904.

He recorded the fact that he had been with the majority of the Court in the decision of the *Freight Association and Joint Traffic Cases* and in the *Addyston Pipe & Steel Company Case*, and that while subsequent discussion and consideration had not disturbed his conviction that those cases were rightly decided, he did think that in some respects the reasons given for the judgments could not be sustained.

"Instead of holding that the Antitrust Act," he said, "included all contracts, reasonable or unreasonable, in restraint of interstate trade, the ruling should have been that the contracts there presented were unreasonable restraints of interstate trade and as such within the scope of the act. That act as appears from its title, was leveled at only 'unlawful restraints and monopolies.' Congress did not intend to reach and destroy those minor contracts in partial restraint of trade which the long course of decisions at common law had affirmed were reasonable and ought to be upheld. The purpose rather was to place a statutory prohibition, with prescribed penalties and remedies, upon those contracts which were in direct restraint of trade, unreasonable and against public policy. Whenever a departure from common law rules and definitions is claimed, the purpose to make the departure should be clearly shown."¹

The important point of the decision in this case was, that no matter in what form an undue restraint upon interstate commerce was imposed, the Sherman Act invalidated it and the Federal equity courts would penetrate corporate organization as well as as any other kind of contract, and require the restraint to be ended. Whether the undue control over commerce were accomplished by agreement between separate individuals or corporations, or by vesting the capital stocks of competing corporations in a third separate corporation, the Sherman Law enabled a Federal court of equity to require the combination to be ended and competitive conditions restored.

Finally, the last step in the authoritative construction and application of the law was taken in the epoch-making decisions

¹ 193 U. S. 361; 1904.

in the cases against the Standard Oil Company and the American Tobacco Company, decided in May, 1911. These cases are so recent and so well known to the bar as to require but little comment here. In them, the Supreme Court for the first time gave thorough consideration to the second section of the act, which is directed against attempts to monopolize interstate trade or commerce. The gravamen of the decision in each case was that in determining the meaning of the words "*every* contract, combination in the form of trust or otherwise, or conspiracy in restraint of trade or commerce," the history of those terms as they were used in the law before the enactment must be considered; that the language of the act, all comprehensive as it is, must be given a *reasonable* construction, not such a narrow verbal one as would entirely destroy the purpose for which the law was enacted. Curiously enough, Justice Harlan, who had advocated precisely this interpretation in his dissenting opinion in the *Knight Case* seventeen years previously, dissented from this conclusion, and in vigorous opinions urged the adoption of a literal construction; while the language employed by the Chief Justice in the prevailing opinions was seized upon by hostile critics for the purpose of convincing the public that some new, strange and artificial construction had been adopted, the effect of which would be to emasculate the act. Yet, as Judge Lanning said in writing the opinion of the Court in the Third Circuit in the *Powder Trust Case* (*E. I. du Pont de Nemours & Company*)¹ decided very shortly after the *Standard Oil* and *Tobacco Cases*:

"From early times it has been a rule of the courts not to construe a legislative act in a literal manner, where it is clear that by such construction the legislative purpose will be defeated; . . ." and

"The recent decisions of the Supreme Court in *Standard Oil Co. v. United States*, and *American Tobacco Co. v. United States*, make it quite clear that the language of the Antitrust Act is not to receive that literal construction which will impair rather than enhance freedom of interstate commerce."

¹ 188 Fed. 149; 1911.

That Judge Lanning correctly interpreted the decisions of the Supreme Court was in effect declared by that tribunal itself in the following year in *Nash v. United States*,¹ where referring to the *Oil* and *Tobacco Cases*, the court said, speaking by Justice Holmes :

"Those cases may be taken to have established that only such contracts and combinations are within the act as by reason of intent or the inherent nature of the contemplated acts prejudice the public interests by unduly restricting competition or unduly obstructing the course of trade."

In the opinion in the *Union Pacific Case*,² the court summed up as follows :

"In the recent discussion of the history and meaning of the act in the Standard Oil and Tobacco Cases this court declared that the statute should be given a reasonable construction with a view to reaching those undue restraints of interstate trade which are intended to be prohibited and punished."

Thus, after a lapse of more than twenty years, did the court declare as a principle of construction, the rule stated by Senator Hoar in closing the debate upon the bill in the Senate in April, 1890, when he said :

"The common law in the States of the Union, of course, extends over citizens and subjects over which the State itself has jurisdiction. Now, we are dealing with an offense against interstate or international commerce which the State cannot regulate by penal enactment and we find the United States without any common law. The great thing that this bill does, except affording a remedy, is to extend the common-law principles which protected fair competition in trade in old times in England to international and interstate commerce in the United States."

It would extend this paper far beyond its necessary limits to consider at length the nature of the evidence upon which courts have held combinations of one kind or another to offend against the prohibition of the Sherman Act.

¹ 229 U. S. 373, 376; 1913.

² 226 U. S. 61; 1912.

Justice Holmes, in the philosophical analysis of the Sherman Law contained in his dissenting opinion in the *Northern Securities Case*,¹ speaks of the sweeping general character of the statute and says :

"It hits 'every' contract or combination of the prohibited sort, great or small, and 'every' person who shall monopolize or attempt to monopolize, in the sense of the act, 'any part' of the trade or commerce among the several States. There is a natural inclination to assume that it was directed against certain great combinations, and to read it in that light. It does not say so. On the contrary, it says 'every' and 'any part.' . . . According to popular speech, every concern monopolizes whatever business it does, and if that business is trade between two States it monopolizes a part of the trade among the States. Of course, the statute does not forbid that. It does not mean that all business must cease. A single railroad down a narrow valley or through a mountain gorge monopolizes all the railroad transportation through that valley or gorge. Indeed, every railroad monopolizes, in a popular sense, the trade of some area. Yet I suppose no one would say that the statute forbids a combination of men into a corporation to build and run such a railroad between the States. . . . Size has nothing to do with the matter. A monopoly of 'any part' of commerce among the States is unlawful. . . . But the act of Congress will not be construed to mean the universal disintegration of society into single men, each at war with all the rest, or even the prevention of all further combinations for a common end.

"There is a natural feeling that somehow or other the statute meant to strike at combinations great enough to cause just anxiety on the part of those who love their country more than money, while it viewed such little ones as I have supposed with just indifference. This notion, it may be said, somehow breathes from the pores of the act, though it seems to be contradicted in every way by the words in detail. And it has occurred to me that it might be that when a combination reached a certain size it might have attributed to it more of the character of a monopoly merely by virtue of its size than would be attributed to a smaller one. I am quite clear that it is only in connection with monopolies that size could play any part."

But he goes on to say, after examples regarding railroads, that the very words of the act made such a distinction impossible in the instant case.

¹ 193 U. S. 402; 1904.

This question of size effected a lodgment in the public mind, although every court in construing the act has repudiated mere size as a criterion of legality. Thus, in the *Standard Oil Case*, the opinion of the Chief Justice dwelt upon the fact that the vast capital aggregated by combining in the New Jersey corporation the stocks of so many other corporations, gave rise to a *prima facie* presumption of intent and purpose to maintain a dominancy over the oil industry, "not as a result of normal methods of industrial development, but by new means of combination which were resorted to in order that greater power might be added than would otherwise have arisen had normal methods been followed, the whole with the purpose of excluding others from the trade and thus centralizing in the combination a perpetual control of the movements of petroleum and its products in the channels of interstate commerce."

And in the *Tobacco Case*,¹ the court, reviewing the history of the combination, held the conclusion of monopolistic purpose to be inevitable, "not because of the vast amount of property aggregated by the combination, not because alone of the many corporations which the proof shows were united by resort to one device or another. Again, not alone because of the dominion and control over the tobacco trade which actually exists, but because we think the conclusion of wrongful purpose and illegal combination is overwhelmingly established by" the various considerations summarized in the opinion.

Judge Noyes, in passing upon the plan of dissolution of the American Tobacco Company in the Circuit Court, Southern District of New York,² said :

"The Supreme Court did not condemn the combination on account of the great amount of property which it had acquired. Indeed, it must now be accepted that magnitude of business in and of itself does not constitute unlawful monopoly, as least up to the point where economy of production and management are thereby promoted. There must be something more — some unlawful or oppressive act or

¹ 221 U. S. 182; 1911.

² 191 Fed. 371, 387; 1911.

purpose in acquiring the business or after its acquisition — to come within the condemnation of the statute.”

In *United States v. International Harvester Co.*¹ Judge Smith said :

“There is no limit under the American law to which a business may not independently grow, and even a combination of two or more businesses, if it does not unreasonably restrain trade is not illegal.”

In the recent decision of the four Circuit Judges of the Third Circuit in the Government's suit against the United States Steel Corporation² Judge Buffington says, after a review of the evidence concerning the size of the business carried on by the defendant :

“These significant figures prove that mere size or bigness of business is not necessarily a monopoly of business at the expense of all others engaged in it. And in that connection and as aptly expressive of our views we may quote with approval the language of Judge Hook of the Eighth Circuit in his concurring opinion in the Standard Oil Case,³

“Success and magnitude of business, the rewards of fair and honorable endeavor were not among the evils which threatened the public welfare and attracted the attention of Congress, but when they had been obtained by wrongful or unlawful methods and competition has been crippled or destroyed, the elements of monopoly are present.”

In the debate on the bill in the United States Senate in April, 1890, Senator Kenna asked whether the Judiciary Committee intended by the use of the words “every person who shall monopolize, etc.” to indicate that if an individual engaged in trade between the States, etc., by his own skill and energy, and by the propriety of his conduct generally, shall pursue his calling in such a way as to monopolize a trade, his action would be a crime under the proposed act.

“Suppose,” he said, “a citizen of Kentucky is dealing in short-horn cattle and by virtue of his superior skill in that particular product it

¹ 214 Fed. 987, 1000; 1914.

² 223 Fed. 55; 1915.

³ 173 Fed. 196; 1909.

turns out that he is the only one in the United States for whom an order comes from Mexico for cattle of that stock for a considerable period, so that he is conceded to have a monopoly of that trade with Mexico; is it intended by the Committee that the bill shall make that man a culprit?"

Senator Hoar replied that it was neither intended, nor did the bill do it, and Senator Edmunds concurred in that opinion, while Senator Hoar added that the word "monopoly" was a technical term known to the common law which had a clear and legal signification, and it is this: "It is the sole engrossing to a man's self by means which prevent other men from engaging in fair competition with him."

In the *Standard Oil Case*, the Chief Justice held that the meaning of the words as employed in the statute was made clear by recourse to the previous history of the law of restraint of trade and the indication which it gave of the practical evolution by which monopoly and the acts that produced the same result as monopoly, that is, an undue restraint of the course of trade, all came to be spoken of as, and indeed to be synonymous with, restraint of trade. In other words, he said:

"Having by the first section forbidden all means of monopolizing trade, that is, unduly restraining it by means of every contract, combination, etc., the second section seeks, if possible, to make the prohibitions of the act all the more complete and perfect by embracing all attempts to reach the end prohibited by the first section, that is, restraints of trade, by any attempt to monopolize, or monopolization thereof, even although the acts by which such results are attempted to be brought about or are brought about be not embraced within the general enumeration of the first section."¹

In the *Steel Corporation Case*, Judge Buffington, after referring to the definitions of the act established by the preceding decisions of the Supreme Court, said that the basic question for the court there to decide was one of fact, namely: whether the union of the several defendant companies in the United

¹ 221 U. S. 61; 1911.

States Steel Corporation "prejudices the public interest by unduly restricting competition or unduly obstructing the course of trade."

"The public interests thus prejudiced," he said, "consist of — first, competitors in trade; second, the purchasing public; and third, the general public. For example, if this Steel Company was in any way guilty of unfair business competition, if it was guilty of such conduct as to unfairly force a competitor out of the steel business, or if it unfairly prevented those who wanted to go into the steel business from doing so, then the Steel Company was, in the judgment of the Supreme Court, prejudicing the public interests by unfairly driving individuals out of business or preventing them from entering it, and it was also injuring the public by unduly restraining trade. So also if this Steel Company was restricting output in order to exact unfair prices; if it was buying up competing plants and dismantling them to needlessly restrict output; if it was by reason of its controlling power furnishing the public with inferior goods; if it was using its power to needlessly and unfairly reduce wages; if it was seeking to deceive purchasers by a false appearance of competition, when in fact it owned or controlled such seeming competition — then it was prejudicing not only that portion of the public which desired to buy steel, but the public interests generally by unduly obstructing the course of trade and thereby preventing the steel business from moving in its natural and normal channel."

Applying these principles, Judge Buffington said it would appear that the questions of fact for the court to determine from the evidence were, viz. :

"First. Was the Steel Corporation, when this bill was filed in 1911, prejudicing the public interests by unduly restricting competition, or unduly obstructing the course of the steel and iron trade, between the States, or with foreign nations? If this question be answered, yes, — the law was then being violated and an injunction should issue to restrain present and future violations.

"Second. Did the Steel Corporation, when it was formed in 1901, either by the intent of those forming it, or by the inherent nature of that Company's contemplated acts, prejudice the public interests by unduly restricting competition or unduly obstructing the course of the steel and iron trade, interstate or foreign? If this question be

answered, yes, — then the law was violated, and the Steel Corporation must be adjudged originally illegal. If illegal, it must be dissolved, because only thus can its inherent nature be prevented from continuing to work further violations of the statute. On the other hand, if these questions are negatived, then the Steel Corporation should not be dissolved, but permitted to pursue that usual course of trade, which it was the purpose, as we have seen, of this statute to protect.”

As the court reached the conclusion that these questions should be answered in the negative, the relief prayed in the bill was denied.

One unsettled question under the act is left for the decision of the Supreme Court; a question which is squarely presented in cases now awaiting argument in that court against the International Harvester Company and the United States Steel Corporation. That question is, whether in a case where a combination has been formed by vesting a corporation with the control through stock ownership or otherwise of a number of competing corporations, thereby suppressing, or empowering the holding corporation to suppress existing competition, and to dominate the commerce in commodities dealt with, but the power so attained has not been unfairly used, competition has not been destroyed, and in fact competitors have increased in number and in the amount of business controlled by them, and at the time the Government sues the defendant corporation actually controls a smaller percentage of the interstate commerce conducted by it than it did when formed, the original unlawful purpose must be attributed to the existing situation, and the combination dissolved.

In the *Harvester Case*¹ a majority of the Circuit Judges in the Eighth Circuit answered that question in the affirmative. (See opinion of Smith, J., at p. 1000.) Judge Hook thus summed up the decision of the court:

“The International Harvester Company is not the result of the normal growth of the fair enterprise of an individual, a partnership

¹ 214 Fed. 987; 1914.

or a corporation. On the contrary, it was created by combining five great competing companies which controlled more than 80 per cent of the trade in necessary farm implements, and it still maintains a substantial dominance. That is the controlling fact; all else is detail."

In the *Steel Case*, two of the judges were of the opinion that no matter what had been the case in the past, the combination would not be dissolved unless the evidence showed a violation of the act when presented to the court, that is whether in that case, "the union of the several defendant companies in the United States Steel Corporation 'prejudices the public interests by unduly restricting competition or unduly restraining the course of trade,'" and that, "the acts of the combination are fair tests of the real inherent nature of the combination, and that in such a case the time-tried rule, 'By their fruits ye shall know them,' might well serve to best gauge the source or tree from or on which the fruit matured" (p. 116).

Judges Hunt and Woolley reached the conclusion that as a matter of fact and law "the *organizers* of the corporation (1) intended to create a monopoly and to restrain trade, and (2) combined with others and attempted to monopolize trade, within the meaning of the act, and that the *corporation* (1) neither attempted nor possessed the power alone to do the unlawful things intended by its formation, but (2) that it unlawfully combined with others to restrain trade by controlling prices." That whatever remedy there might be against the organizers of the corporation for acts violative of the statute, "certainly in this proceeding in equity a decree of dissolution cannot be awarded against the corporation for the unlawful intent and the unsuccessful attempt of its organizers to violate the law. Upon the finding that the corporation in and of itself is not now and has never been a monopoly or a combination in restraint of trade, a decree of dissolution should not be entered against it." But as they found that the corporation had violated one of the provisions of the statute by combining with others to unduly restrain trade, and possessed

the power to again unlawfully combine with others to do the same unlawful acts, although not at the moment actively threatening the same, yet because of the disposition displayed throughout a large portion of its history, it might again do so, these two judges were of opinion that the corporation should be prevented from doing the things and repeating the practices respecting the fixing and maintaining of prices which they viewed as illegal.

As we have seen, the Anti-trust Law is entitled, "An act to protect trade and commerce against unlawful restraints and monopolies," and by the third section, the several Circuit Courts of the United States are invested with jurisdiction "to prevent and restrain violations of this act." The power given in this brief and comprehensive language has been held to justify the application of remedies twofold in character, viz.: first, to forbid the doing in the future of acts such as those which the court finds to have been done in the past, which would be violative of the statute; and second, the exertion of such measure of relief as will effectually dissolve the combination found to exist in violation of the statute.¹

In ordinary cases of combinations, such as that presented in the *Addyston Pipe & Iron Company Case*, an injunction against the continuance of the combination is effective to secure the relief sought. In the *Northern Securities Case*, the decree of the Circuit Court, following the prayer of the bill, enjoined the Securities Company from voting the stocks in the Railway Companies held by it, or from collecting dividends on them, but provided that nothing in the decree should be construed to prohibit the Securities Company from returning the stocks of the respective Railway Companies to the holders and owners of its own stock originally issued in exchange or payment for the stocks of the Railway Companies. After the affirmance of the decree by the Supreme Court, the Securities Company,

¹ *Standard Oil Co. v. United States*, 221 U. S. 78; 1911. *United States v. Union Pacific Railroad Company*, 226 U. S. 96; 1912.

instead of attempting to return the stocks of the Railway Companies held by it to the individuals from whom it had received them in exchange for its own stock, reduced its capital from \$400,000,000 to a trifle under \$4,000,000, and directed the distribution of the stocks of the Railway Companies held by it *pro rata* among all of its stockholders. Mr. Harriman and the Union Pacific Railroad Company objected to this distribution, contending that they should get back what they had put in, and brought suit to compel the Securities Company to make this return; but the courts denied them that relief, holding that the *pro rata* distribution was proper. In the opinion of the Supreme Court, the Chief Justice said, referring to the suit by the United States against the Northern Securities Company:

"Some of our number thought that as the Securities Company owned the stock, the relief sought could not be granted, but the conclusion was that the possession of power, which, if exercised, would prevent competition, brought the case within the statute, no matter what the tenure of title was."

After reviewing the whole situation, he concluded in this language:

"Doubtless it became the duty of the Securities Company to end a situation that had been adjudged unlawful, and this could be effected by sale and distribution in cash, or by distribution in kind, and the latter method was adopted, and wisely adopted, as we think, for the forced sale of several hundred millions of stock would have manifestly involved disastrous results. In fine, the title to these stocks having intentionally been passed, the former owners or part of them cannot reclaim the specific shares and must be content with their ratable proportion of the corporate assets."¹

Throughout the discussion in all the courts, it appeared to be recognized that no principle of law could prevent the same group of individuals from acquiring and owning stocks in competing corporations in the same proportions, but that the law

¹ 197 U. S. 244, 298; 1905.

did condemn the acquisition of a perpetual control of competing corporations by vesting their stocks in corporate hands, thereby preventing the ultimate distribution of ownership which always results from individual stockholding. In 1895, when an effort was made on behalf of the Great Northern Railroad Company to secure control of the Northern Pacific Railway by putting the stock of the latter in the hands of a trustee for the benefit of the stockholders of the Great Northern, the Supreme Court had, while condemning that agreement, expressly recognized that individual stockholders could lawfully acquire by purchase a majority or even the whole of the stock of another and competing company, but it was pointed out that in such case the companies would still remain *separate corporations*, with no interests as such in common, and that within a short time by sales of the stock so acquired, the control of those corporations might, and in all probability would, become fully dissevered. In the *Northern Securities Case*, Justice Holmes, in his dissenting opinion, said :

“I do not expect to hear it maintained that Mr. Morgan could be sent to prison for buying as many shares as he liked of the Great Northern and the Northern Pacific, even if he bought them both at the same time and got more than half the stock of each road.”¹

The decree entered by the Circuit Court in the *Standard Oil Case* enjoined the Standard Oil Company from voting the stocks of its twenty odd subsidiary corporations, from collecting dividends upon them, or through the ownership of those stocks from exercising any control over such subsidiary corporations; but it specifically provided, that “the defendants are not prohibited by this decree from distributing ratably to the shareholders of the principal Company the shares to which they are equitably entitled in the stocks of the defendant corporations that are parties to the combination.” This decree was affirmed by the Supreme Court, with a slight modification,

¹ 193 U. S. 409; 1904.

thus in effect approving this method of dissolving the unlawful combination; the court taking pains to say that in applying remedies "the fact must not be overlooked that injury to the public by the prevention of an undue restraint on or the monopolization of trade or commerce, is the foundation upon which the prohibitions of the statute rest, and moreover, that one of the fundamental purposes of the statute is to protect, not to destroy, rights of property."¹ But in the case of the unlawful combination found to have been created by the acquisition by the Union Pacific Railroad Company of a controlling interest in the stock of the Southern Pacific Company, the Supreme Court took occasion to say that in order to conclude the operating force of the combination, a disposition should be made of the shares of stock acquired by the Union Pacific Company, subject to the approval and decree of the District Court, and that any plan for the disposition of that stock must be such as to effectually dissolve the unlawful combination thus created. It directed the District Court to proceed, upon the presentation of any plan, to hear the government and the defendants, and to bring in any additional parties whose presence might be necessary to the final disposition of the stock in conformity to the views expressed in the opinion of the court.¹

For the purpose of more clearly elucidating the meaning of this provision in the opinion of the court, an application was made to the court by both the Attorney-General and the representatives of the defendant Company for further instructions, by provision, to be incorporated in the mandate, or otherwise, as to whether or not a sale of the Southern Pacific stock to and among the stockholders of the Union Pacific substantially in proportion to their respective holdings, or the distribution thereof by dividends to Union Pacific stockholders entitled to such dividends, would, in the opinion of the court, constitute a disposition of such shares in compliance with its previous opinion. The court entertained the motion, and held that such

¹ 226 U. S. 61, 97; 1912.

a distribution would not so effectually end the combination as to comply with its decision; that the main purpose of the Anti-trust Law was to prevent combinations and conspiracies in undue restraint of trade, or intending to monopolize it, and that the object of proceedings of this character was to decree by as effectual means as a court may, the end of such unlawful combinations and conspiracies.

"So far as is consistent with this purpose," they said, "a court of equity dealing with such combinations should conserve the property interests involved, but never in such wise as to sacrifice the object and purpose of the statute. The decree of the courts must be faithfully executed and no form of dissolution be permitted that in substance or effect amounts to restoring the combination which it was the purpose of the decree to terminate."¹

In the *American Tobacco Company Case* the Supreme Court said:

"Our conclusion being that the combination as a whole, involving all its coöperating or associated parts, in whatever form clothed, constitutes a restraint of trade within the first section, and an attempt to monopolize or a monopolization within the second section of the antitrust act, it follows that the relief which we are to afford must be wider than that awarded by the lower court; . . . but in order to enable us to award relief coterminous with the ultimate redress of the wrongs which we find to exist, we must approach the subject of relief from an original point of view."

The court then pointed out, that a mere decree forbidding stock ownership by one part of the combination in another part, or an entity thereof, would afford no adequate measure of relief, since different ingredients of the combination would remain unaffected, and by the very nature and character of their organization would be able to continue the wrongful situation which it was their duty to destroy. Considering all of the questions involved and the difficulties which presented themselves, in view of the extent of the combination, the vast

¹ 226 U. S. 470, 477; 1913.

field which it covered, the all-embracing character of its activities concerning tobacco and its products, to at once enjoin the movement in interstate commerce of the products which the combination or its operating forces produced or controlled, might effect infinite injury on the public by the stoppage of immediate supply and the great enhancement of prices; and to at once resort to a receivership might not only do grievous injury to the public, but cause widespread and perhaps irreparable loss to many innocent people. Under all these circumstances, the court decreed that the combination in and of itself, and as to all of its elements, was unlawful under the first and second sections of the Antitrust Act; that the District Court should hear the parties for the purpose of ascertaining and determining upon some plan or method of dissolving the combination and of re-creating out of the elements then composing it a new condition which would be honestly in harmony with and not repugnant to the law, and that for this purpose a period of six months was allowed from the receipt of the mandate of the Supreme Court, with the right to an extension of not to exceed sixty days; and that if before the expiration of that period "a condition of disintegration in harmony with the law is not brought about, either as the consequence of the action of the court in determining an issue on the subject, or in accepting a plan agreed upon, it shall be the duty of the court, either by way of an injunction restraining the movement of the products of the combination in the channels of interstate or foreign commerce, or by the appointment of a receiver, to give effect to the requirements of the statute."¹

It is safe to say that no task ever has been imposed upon the law officers of the government and the judges of a court comparable in magnitude and complexity to that which was thus devolved upon the Department of Justice and the Judges of the Second Circuit by this decree of the Supreme Court. The combination which the Supreme Court adjudged "as a whole,

¹ 221 U. S. 187, 188; 1911.

involving all its coöperating or associated parts, in whatever form clothed," to constitute a restraint of trade within the first section, and an attempt to monopolize or a monopolization within the second section of the Anti-trust Act, was composed of sixty-five separate corporations of different States and twenty-nine individuals. The American Tobacco Company which, by the direct or indirect ownership of properties and stocks of other corporations, exercised effective control of the combination, had outstanding issues of \$78,000,000 of preferred stock, without voting power, distributed to the public, and \$40,000,000 of common stock, with voting power, the majority of which was controlled by the twenty-nine individual defendants, and it also had outstanding in the hands of the public two issues of bonds, aggregating upwards of \$104,000,000. The combined assets of the combination at the date of the filing of the bill in 1907, amounted to more than \$400,000,000, and the combined income of the companies for that year exceeded \$36,000,000. Excluding cigars, the American Tobacco Company and its subsidiaries manufactured and distributed more than 75 per cent of all tobacco products of the United States, and they were engaged in business and owned property in almost every State of the Union and in many foreign countries. The Supreme Court had laid down as principles which must guide the action of the court in terminating the existing wrongful situation :

"1. The duty of giving complete and efficacious effect to the prohibitions of the statute; 2, the accomplishing of this result with as little injury as possible to the interest of the general public; and 3, a proper regard for the vast interests of private property which may have become vested in many persons as a result of the acquisition either by way of stock ownership, or otherwise, of interests in the stock or securities of the combination, without any guilty knowledge or intent in any way to become actors or participants in the wrongs which we find to have inspired and dominated the combination from the beginning." ¹

¹ 221 U. S. 185; 1911.

There were no precedents to furnish any guide in working out the required plan of disintegration. No machinery had been provided by Congress to aid either the court or the Department of Justice in discharging the task. That it was accomplished, that a combination of such magnitude and complexity was disintegrated without the loss of a dollar to public or private interests, save the curtailment for the future of the monopolistic profits which theretofore had resulted from the combination; that bond issues of upwards of \$100,000,000 were paid off without the loss of a dollar; that the holders of seventy-eight million dollars in preferred stock received its equivalent value in new securities, and that the business, which was largely one of brands, was distributed among fourteen separate distinct and competing corporations, and that the will of the Supreme Court was adequately carried out and its caution specifically followed, — will ever remain, to those who were responsible for the result, a source of abiding gratification.

The voting power which had controlled this vast corporation by being lodged in the hands of the holders of a majority of the \$40,000,000 of common stock, was distributed among the holders of all the new stocks, including not only that amount of common stock, but also the \$78,000,000 of preferred stocks. The business of the combination was divided up among fourteen separate and distinct corporations in such manner that no one was given an amount of the business in any particular line in excess of 40 per cent of the business of the country in that line, and save in one or two instances, not in excess of one third of such business. The various brands were so distributed among the respective companies that no one company had the advantage in brands over another. No company was given a dominant position in the purchase of any particular type of leaf tobacco from another. The licorice business, the tin foil business and the snuff business were separated from the tobacco business, and transferred to separate corporations, and the companies engaged in foreign business

were divorced entirely from the domestic companies. This plan of distribution was submitted to and approved as economically sound by experts of the Bureau of Corporations of the Department of Commerce and Labor, who had, through a study of years, become thoroughly familiar with the tobacco industry. All restrictive covenants, foreign and domestic, were terminated. The twenty-nine individual defendants, who had controlled the combination in the past, were enjoined from increasing their holdings in any of the new companies. The fourteen new companies were specifically enjoined from conveying property from one to the other, from acquiring stock in one another and from lending financial assistance to each other. They were enjoined from making agreements with each other as to prices, terms of purchase or sale of leaf tobacco or other products dealt in by them, or apportioning business among themselves with respect to localities. Every company was enjoined from employing the same business organization as that of another company, from having the same purchasing or selling agents, and from occupying the same offices. They were enjoined from having common directors or common officers. Every distributee company was enjoined from doing business except in its own name or in that of a subsidiary company, and where business was done in the name of a subsidiary, it was provided that the product should bear the name of the controlling company. They were enjoined from selling any brand or product on condition that the purchaser should also buy from the vendor some other brand manufactured or sold by it.

This plan, as the Circuit Court, speaking by Judge Noyes, said:

"has been built up almost in our presence, and whatever question there may be as to its merits there is none of the good faith of its authors, nor of the ability and conscientiousness with which they have performed their task."¹

¹ 191 Fed. 386; 1911.

It was unanimously approved by the four Circuit Judges, every one of whom wrote an opinion. It was at once made the object of bitter partisan attack on the part of those who desired to see all business reduced to small retail units on the one hand, on the part of political partisan opponents to the national administration then in power on the other hand, and also on the part of theorists with no sense of responsibility for the vast interests at stake, and who entertained a totally mistaken idea of the nature and purpose of the law which compelled the dissolution.

On the hearing before the Circuit Court, the Attorney-General urged that the decree should reserve to the government the right at any time within five years from the date of its entry to apply to the court for other and further relief, upon a showing that, as a matter of fact, such plan had not resulted in creating a new condition which should be honestly in harmony with and not repugnant to the law. He pointed out to the court that it was obvious that any plan submitted to the consideration of the court must be more or less a matter of conjecture, and that it was impossible for the court to determine in advance whether or not a plan which proposed to restore competitive conditions would actually accomplish the purpose intended. The Circuit Court declined to accede to this suggestion, upon the ground that it was beyond its power. Neither in the mandate of the Supreme Court, said Judge Lacombe,

“nor in its opinion, is there any warrant for the conclusion that this court is to prescribe the temporary terms of a *modus vivendi*, with power to reassemble five years hence, ourselves or our survivors and successors, and modify those terms, while in the interim by purchase or exchange of these bonds, upwards of \$100,000,000 worth of property shall have changed hands irrevocably. The only function assigned to us is to consider any proposed plan which responsible parties engage to carry out, and approve or reject it. In the event of rejection the only alternative is injunction, receivership and sale. The time limit fixed in the mandate — six months, and possibly two more — precludes any other construction of its terms.”

A different view has been since taken by other courts. Thus in the *Keystone Watch Company Case*, the Circuit Judges in the Third Circuit, while directing that an injunction should issue to restrain the corporation defendant from repeating the performance of the acts theretofore done by it which were held to be in violation of the Anti-trust Law, declined to break up the existing corporate entity, on the ground that they saw no sufficient evidence that the public interests required such action; but they added:

"In case conditions in the future should make it desirable for the government to ask for additional relief, even to the point of breaking up the defendant corporation, we shall retain jurisdiction of the bill with leave to the government to take such action hereafter as may seem appropriate."¹

In the *United States Steel Corporation Case*, the court held that the government had not made out a case that should be followed by a decree of dissolution, but some of the judges being of opinion that the corporation should be prevented from doing certain things and repeating certain practices respecting the fixing and maintaining of prices which were regarded as illegal, the court decided that if desired by the government, it would retain jurisdiction of the bill for the purpose of allowing future application to be made to restrain the doing of such illegal acts in case they should be repeated in the future. And in the suit against the American Can Company, recently decided by Judge Rose at Baltimore, similar action is reported to have been taken.

Shortly after the decree of dissolution in the *Tobacco Case*, the so-called Powder Trust was dissolved by decree of the Circuit Court in Philadelphia. By that decree entered June 13, 1912, a large number of subsidiary corporations belonging to the illegal combination were ordered to be dissolved and their properties to be distributed among the stockholders. The

¹ 218 Fed. 502, 519; 1915.

main businesses of the manufacture of dynamite, black blasting powder, black sporting powder and smokeless powder, were ordered distributed between three companies, two of them newly incorporated for the purpose. The value of the property transferred by the parent company to the two new companies was under the decree to be represented by 50 per cent in bonds and 50 per cent in stock, and the court decreed that one half of the stocks which should be distributed to the individual defendants who had brought about and controlled the combination, should be without voting power and should have no voting power so long as such stock was held by any one of such defendants or their respective wives or children. The decree further enjoined the distributee companies from conveying property one to the other, from making agreements between each other, or having common officers, directors or clerical forces, and from acquiring stock in one another.

In passing upon an application for the construction of its mandate in the *Union Pacific Case*, the Supreme Court said :

"As was said in the opinion filed in this case, however, each case under the Sherman Act must stand upon its own facts, and we are unable to regard the decrees in the Northern Securities Company case and the Standard Oil Company case as precedents to be followed now in view of the different situation presented for consideration."¹

And in finally determining a very vexed question as to the form of the decree to be entered against the Great Lakes Towing Company, which the District Court in the Northern District of Ohio had adjudged to constitute an unlawful combination,² that court, composed of the three Circuit Judges, reviewed the history of the relief which had been granted in different cases for the purpose of preventing and restraining continued violations of the Sherman Act, as follows :

"In the *Northern Securities Case*, 193 U. S. 197 ; 1904, dissolution was accomplished by requiring such Securities Company to largely reduce

¹ 226 U. S. 474 ; 1913.

² 208 Fed. 733 ; 1913.

its own stock and in lieu of the stock so retired to distribute to its own stockholders a proportionate amount of the competitive stocks held by it. In the *Standard Oil Case*, 221 U. S. 1; 1911, the New Jersey corporation which held the stocks of a large number of other corporations in exchange for its own, was required to distribute the stock so held among its own stockholders. In the *Tobacco Case*, 221 U. S. 106; 1911, the business was divided between four corporations; the controlling companies being again so subdivided that business control was in the hands of a large number of separate corporations. Certain stock distributions were made and injunctive relief given. In the *Union Pacific Case*, 226 U. S. 470; 1913, dissolution was affected by the sale of the Southern Pacific stock. In the *Reading Case*, the unlawful combination was held to exist as to the Temple Iron Company and the 65 per cent contracts, and defendants were enjoined from voting the stock of the Iron Company, the contracts referred to were cancelled, and their further execution enjoined. In the *St. Louis Terminal Case*, 224 U. S. 383; 1912, the unlawful condition was relieved against by such revamping of conditions as that all the railroad companies could get the benefit of the terminal facilities on equal terms. It is thus seen that even where the remedy by injunction is thought to be inadequate, there is no uniform rule respecting the means to be employed in putting an end to the unlawful combination. Each case must stand upon its own facts; and methods adopted in other cases are not necessarily to be followed as precedents, except where the same situation is presented. *Union Pacific Case*, 226 U. S. 470; 1913."¹

In most instances, the result is accomplished, as was done in the *Tobacco Case*, by adjudging the defendants to be in unlawful combination and providing that unless a plan to restore legality be adopted and approved by the court within a given time, injunction and receivership shall go. This, of course, requires the parties to devise and submit to the law officers of the government and to the court a plan which will terminate the existing illegal condition and afford satisfactory guarantees against the re-creation in the future of the unlawful *status*.

The Federal Trade Commission Act,² recently enacted, contains the following provision, which is substantially what was recommended by the Attorney-General to Congress in his

¹ 217 Fed. 659; 1914.

² 38 U. S. Stat. at Large 717.

annual report for 1911 after the adoption of the plan of disintegration of the Tobacco Trust:

"Whenever a final decree has been entered against any defendant corporation in any suit brought by the United States to prevent and restrain any violation of the antitrust acts, to make investigation, upon its own initiative, of the manner in which the decree has been or is being carried out, and upon the application of the Attorney-General it shall be its duty to make such investigation. It shall transmit to the Attorney-General a report embodying its findings and recommendations as the result of any such investigation, and the report shall be made public in the discretion of the commission. . . .

"Upon the application of the Attorney-General to investigate and make recommendations for the readjustment of the business of any corporation alleged to be violating the antitrust acts in order that the corporation may thereafter maintain its organization, management and conduct of business in accordance with law.

"That in any suit in equity brought by or under the direction of the Attorney-General as provided in the antitrust acts, the court may upon the conclusion of the testimony therein, if it shall be then of opinion that the complainant is entitled to relief, refer said suit to the commission as a Master in Chancery to ascertain and report an appropriate form of decree therein. . . . The commission shall proceed upon such notice to the parties and under such rules of procedure as the court may prescribe and upon the coming in of such report such exceptions may be filed and such proceedings had in relation thereto as upon the report of a master in other equity cases, but the court may adopt or reject such report in whole or in part and enter such decree as the nature of the case may in its judgment require."¹

About fifty-four decrees in equity dissolving combinations, have been entered in the various Circuit and District Courts of the United States, beginning with the decree entered June 17, 1891, in the Circuit Court for the Middle District of Tennessee against the Jellicoe Mountain Coal & Coke Company, down to and including the most recent decrees, namely; that entered January 20, 1916, in the District Court for the Western District of New York against the Eastman Kodak Company and others, and that entered in the District Court of the Eastern

¹ *Ibid.*

District of Pennsylvania on January 24, 1916, against the Motion Picture Patents Company and others. The combinations dissolved by these decrees were of infinite variety. They included traffic associations between railroad companies, such as those described in the *Joint Traffic*¹ and *Traffic Association Cases*²; combinations between competing manufacturers for the purpose of suppressing competition, such as that before the court in the *Addyston Pipe Case*; the control by one corporation of the capital stock of two competing transcontinental railway systems (*Northern Securities Co. v. U. S.*³); the control by one corporation of the capital stock of another competing railroad (*U. S. v. Union Pacific*⁴); a combination controlling all the terminals in the city of St. Louis (*U. S. v. Terminal Railway Association*⁵); combinations of wholesale grocers; of manufacturers of incandescent electric lights; of dealers in plumbing supplies; of manufacturers of kindling wood; of retail lumber dealers, — having for their purpose the suppression of competition and the control of prices; combinations of owners of patents extending the monopoly secured by the Patent Laws beyond the scope of those statutes; pooling agreements formed for the control of the price of cotton, and various other contracts and combinations which on the evidence were held to constitute undue restraints upon interstate or foreign commerce, or an attempt to monopolize the same. In all of these cases, the decrees dealt comprehensively with contracts, organizations or practices which had grown up or had been formed between two substantial competitors in a given line, for the purpose of excluding competition or fixing prices, and by various conveyances, transfers, cancellations and dissolutions broke them up, and then, by injunctions forbidding specified acts, made provision against their renewal in the future.

It only remains to consider the criminal provisions of the

¹ 166 U. S. 290; 1897.

² 171 U. S. 505; 1898.

³ 193 U. S. 197; 1904.

⁴ 226 U. S. 61; 1912.

⁵ 224 U. S. 383; 1912.

statute. All of the acts which it declares unlawful are also made misdemeanors, punishable by fine and imprisonment. But while prosecutions have from time to time been brought to enforce these penalties, juries have shown great reluctance to convict individual defendants, and in the few instances where convictions have been had, the penalty of imprisonment has but seldom been imposed, and in every instance, but one, where imprisonment has been imposed by the court upon a defendant the judgment has been reversed on appeal. Such was the case of the prosecution of the members of the so-called Turpentine Trust in Savannah (*Nash v. U. S.*¹) and the conviction of the officers of the National Cash Register Company in Cincinnati, Ohio (*Patterson v. U. S.*²). In the sole case where the appellate court affirmed the conviction which carried a sentence of imprisonment, namely, that of the so-called Night Riders in Kentucky, the President commuted the sentences and remitted the penalty of imprisonment. It is true that in a large number of instances, fines have been imposed and collected, and the liability to criminal prosecution undoubtedly has served as a deterrent, particularly in recent years, against conscious violation of the law.

The decisions thus reviewed have demonstrated the Sherman Anti-trust Law to be an effective instrument for the accomplishment of the purposes which the national legislature had in view upon its enactment. It may seriously be doubted whether the so-called Clayton Law, enacted at the last session of Congress, has not, in its effort to add specific prohibitions to the broad general denunciation of unlawful restraint on interstate and foreign commerce embodied in the Sherman Law, really weakened the provisions of that great enactment. It has become a fashion of speech in some quarters to speak of the Sherman Law as having been a failure. That the policy adopted by Congress of seeking to prevent the arbitrary and far-reaching centralization of power over industry which was making

¹ 229 U. S. 373; 1913.

² 222 Fed. 599; 1915.

startling progress at the time of its enactment was demanded by a regard for the national health and welfare, hardly can be questioned; that the Sherman Law, mistaken as was the original conception of its provisions by some of the courts, halting and imperfect as for a long time was its application, in the light of modern interpretation has been made an effective means of enforcing the rule of competition, as against the rule of combination, can admit of no candid doubt. There is, of course, a certain borderland of uncertainty in its application. It may frankly be conceded, too, that in many instances healthy cooperation makes for the public welfare more than destructive competition. I have always thought that a different rule should be applied with respect to foreign trade and commerce than as regards domestic trade. When American business seeks expansion in foreign countries, it meets conditions over which it has no control. In many foreign countries the rule of competition has been abolished and state control of associated industry has been substituted for it. To send American merchants into fields so controlled, prohibited from combining for their own protection, is like sending ordinary State militia regiments to contend with the trained armies of France or Germany. But that the consideration which moved the statesmen of 1890 to frame the Sherman Law was a wholesome fear of the effect upon Republican institutions of the centralization in a few hands of control over American industry, appears to me to be beyond dispute. That the law they enacted has, through the construction finally given to it by the Supreme Court, achieved its main purpose now has been irrefutably demonstrated.

THE FEDERAL TRADE COMMISSION AND THE CLAYTON ACT

A Lecture Delivered before the Association of the Bar of the City of New
York, by Gilbert H. Montague, March 22, 1916

THE Sixty-third Congress convened for its Second Session in December, 1913, with antitrust legislation for its chief appointed work. The Presidential campaign of 1912 had been largely waged upon the issue of trusts; and Mr. Wilson took pains frequently during the campaign to attack the Progressive party for tolerating, under its proposals of regulation, the existence and development of business units and combinations so large as to constitute substantial dominance in their respective industries.

A Trade Commission, of some kind, was proposed in the platforms of the Democratic, the Republican and the Progressive parties. But the Democratic party, influenced apparently by the recommendation of the Stanley Committee which had investigated the United States Steel Corporation, proposed also a program of legislation, supplementary to the Sherman Act, which should specify and enumerate, in definite language, certain acts as *ipso facto* violations of the antitrust laws; and the Republican party, influenced apparently by the report of Senator Cummins from the Senate Committee on Interstate Commerce on antitrust legislation in 1912, and by the proposals for antitrust legislation that had been introduced and agitated by Congressman Lenroot and Senator La Follette, declared even more definitely for "the enactment of legislation supplementary to the existing antitrust act, which will define, as criminal offenses, those specific acts that uniformly mark attempts to restrain and monopolize trade." The refusal of the Progressive party to take such advanced ground in this direction, and the

which was reported with a report of the whole Committee to the House on April 14th. All the Republican members of the Committee concurred in this report. Mr. Stevens, of New Hampshire, however, a Democratic member of the Committee, submitted, on April 20th, a minority report, which foreshadowed provisions far in advance of any in the bill as reported. Mr. Stevens said :

"The bill reported by the majority of the committee takes no steps toward the proper regulation of competition. The new commission has no more power than the old Bureau of Corporations, which it supplants. Apparently a large part of its time will be devoted to merely aiding the Department of Justice in the enforcement of the antitrust acts. The Department of Justice undoubtedly needs the aid of an expert board in its work, but an independent trade commission should have a far broader purpose.

"My own views of the scope and power of an interstate trade commission are embodied in H. R. 15660. This bill confers upon the trade commission all the powers of investigation conferred by the committee bill, with two important additions, one of which is fundamental.

"(1) The commission is given the discretionary power to require those corporations which furnish annual reports to adopt as far as it is practical a uniform system of accounts. Annual reports, unless based upon a sound and uniform system of accounting, convey little information and are of little value for the sake of comparisons. This provision follows the present Interstate Commerce Commission law. The work of the Interstate Commerce Commission has been made much more effective by giving it power to compel the railroads to adopt uniform accounts. I see no reason why corporations which are doing the same kind of business might not be classified and required to adopt uniform account systems like the railroads.

"(2) Section 10 of H. R. 15660 declares unfair and oppressive competition to be unlawful and directs the commission to enforce the law. I have not attempted to define unfair or oppressive competition. That is a question of fact to be decided by the commission the same way that the Interstate Commerce Commission decides what rates and practices of the railroads are unreasonable and unfair. Unless the commission is to have some power to regulate competition it would seem hardly worth while to abolish the Bureau of Corporations."

On June 5th, the Interstate Trade Commission bill, as reported by the Committee, passed the House.

In the Senate the Interstate Trade Commission bill was referred to the Senate Committee on Interstate Commerce. On June 13th, Senator Newlands, Chairman of the Committee, reported the bill with amendments embodying substantially the additions that Congressman Stevens had proposed. After a spirited debate the bill passed the Senate by a vote of 53 to 16.

The bill, then known as the Federal Trade Commission bill, then went to conference, from whence it emerged on September 4th, and was thereupon adopted, and on September 26th was signed by the President.

Meanwhile Mr. Clayton's tentative bills above described were progressing.

On April 14th, Mr. Clayton introduced a bill¹ which included substantially the provisions of the tentative bills hereinbefore discussed, and a provision that nothing in the antitrust laws should be construed to forbid the existence or operation of labor and agricultural organizations, and also provisions that defined the practice in respect of injunctions. On May 6th, this bill was reported to the House with amendments. On June 5th, the bill passed the House.

In the Senate the bill was referred to the Senate on Judiciary. On July 22d, Senator Culberson, Chairman of the Committee, reported the bill to the Senate with amendments. These included provisions giving the Trade Commission and Interstate Commerce Commission authority to enforce compliance with sections prohibiting certain kinds of price discrimination, interlocking directorships, intercorporate stockholding and exclusive contracts. The Senate debated the bill from July 22d until September 2d. It struck out the provisions regarding price discriminations and exclusive contracts. Later it put back a substitute for the exclusive contract provision. It

¹ H. R. 15,657, 63d Cong.

added several sections relating to carriers. On September 2d, the bill as amended passed the Senate by vote of 46 to 16.

The bill then went to conference from whence it emerged on September 23d. In the Senate a spirited debate followed, but a motion to recommit was lost by vote of 35 to 25, and the bill, as reported from conference, was finally agreed to on October 5th, by a vote of 35 to 24. On October 8th the bill, as reported, was agreed to by the House by vote of 244 to 54, and on October 15th was signed by the President.

II

Several remedies have been added to the Sherman Act by the Clayton Act.

Section 4 of the Clayton Act, closely following the language of section 7 of the Sherman Act, provides :

“That any person who shall be injured in his business or property by reason of anything forbidden in the anti-trust laws may sue therefor in any district court of the United States in the district in which the defendant resides or is found or has an agent, without respect to the amount in controversy, and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney’s fee.”

Section 12 of the Clayton Act provides that

“ . . . all process in such cases may be served in the district of which it is an inhabitant, or wherever it may be found.”

The “district in which the defendant resides or is found,” within the meaning of section 7 of the Sherman Act, is the district in which the defendant, at the commencement of the action, resides, or, being a corporation, is domiciled, or where the defendant is physically present, or, being a corporation, actually has some kind of agent, or is actually transacting some kind of business of such character as fairly to give it situs in that district. This district, under the Sherman Act, was the only

district in which the defendant could be sued; save only in the exceptional cases provided for in section 5 of the Sherman Act, when, in Government suits, "the ends of justice require that other parties should be brought before the court."

This was not appreciated by Congress. In the report of the House Judiciary Committee on the Clayton Bill, the Committee said that "under the law as it now exists, a suit against a corporation must be brought in the district whereof it is an inhabitant." The same error was repeated in the report of the Senate Judiciary Committee. These reports, and the discussion of these sections on the floor of Congress, indicate that the language of section 7 of the Sherman Act was departed from only in the attempt to arrive at the result that had already been reached by the Sherman Act.

The words above quoted, which section 12 of the Clayton Act has added to the law, have raised a question of interpretation. And it has been held by one court¹ that the legislative intent to expand the jurisdiction of the court, so far as service of initial process is concerned, beyond that defined in section 7 of the Sherman Act, is quite clear:

"Ordinarily, process either of a state court or a District Court of the United States cannot be served beyond the territorial limits of the state or of the district, as the case may be. A non-resident corporation may be doing business in a district, and therefore theoretically be liable to suit therein; but if it is not represented therein by an agent, upon whom process against it may be legally served, it cannot, against its will, be brought into court. The framers of the Clayton Act, however, have taken care that suits authorized by it shall not be so obstructed. . . .

"A corporation may be sued under this statute where it transacts business. It cannot escape the obligation to respond because no agent of it, of the rank and character qualified to be served for it, can be there found. Suit may be there brought and process may issue to a district in which it cannot deny its liability to service."

¹ *Frey & Son v. Cudahy Packing Company*, 228 Fed. 209, D. C. Maryland, 1915.

The court, accordingly, held that suit might be commenced in Maryland, by service of summons and declaration in Illinois, against an Illinois corporation doing business in Maryland.

Section 5 of the Clayton Act provides in part as follows :

"That a final judgment or decree hereafter rendered in any criminal prosecution or in any suit or proceeding in equity brought by or on behalf of the United States under the anti-trust laws to the effect that a defendant has violated said laws shall be *prima facie* evidence against such defendant in any suit or proceeding brought by any other party against such defendant under said laws as to all matters respecting which said judgment or decree would be an estoppel as between the parties thereto: *Provided*, This section shall not apply to consent judgments or decrees entered before any testimony has been taken: *Provided further*, This section shall not apply to consent judgments or decrees rendered in criminal proceedings or suits in equity, now pending, in which the taking of testimony has been commenced but has not been concluded, provided such judgments or decrees are rendered before any further testimony is taken."

As passed by the House, the Clayton Act made such decrees *conclusive*, instead of *prima facie*, evidence against the defendant, and contained none of these provisos.

Anxiety regarding the constitutionality of the measure appears to have prompted the change from "conclusive" to "prima facie," and the proviso in respect of defendants that already had consented to decrees. And a common-sense attitude toward defendants desiring hereafter to consent to decrees without contest appears to have prompted the second proviso.

Such consent, under certain circumstances, in some jurisdictions, may make the judgment or decree proper evidence as an admission against interest, and available against the defendant, in suits by third parties.¹ This possibility, however, existed

¹ Compare the following cases of former judgments taken upon the defendant's plea of guilty: *Clark v. Irvin*, 9 Ohio 131; 1839. *Bradley v. Bradley*, 11 Maine 367; 1834. *Green v. Bedell*, 48 New Hampshire 546; 1869. *Schreiner v. High Ct. of F.*, 35 Ill. App. 576; 1890. *Crawford v. Bergen*, 91 Iowa 675; 1894. 23 Cyc. 1349. Compare the following case of former judgment taken upon the defendant's plea of *nolo contendere*: *Commonwealth v. Horton*, 9 Pickering

before the Clayton Act, and is quite unaffected by it. Except for this, the section undoubtedly constitutes a real inducement to defendants to consent to decrees without contest.

Whether this section will ever fulfill to private complainants, in their actions against defendants already condemned in Government suits under the antitrust laws, the full measure of assistance that it seems to promise may well be doubted.

The limitation of the effect of this section to "matters respecting which said judgment or decree would be an estoppel as between the parties thereto" requires the complainant first to ascertain just what matters have been conclusively determined and become *res adjudicata* between the Government and the defendant, and just what are the issues in respect of which there is an estoppel between the Government and the defendant by virtue of the judgment or decree.

"The general principle announced in numerous cases," said the Supreme Court in *Southern Pacific Railroad v. United States*,¹

"is that a right, question, or fact distinctly put in issue and directly determined by a court of competent jurisdiction, as a ground of recovery, cannot be disputed in a subsequent suit between the same parties or their privies; and even if the second suit is for a different cause of action, the right, question, or fact once so determined must, as between the same parties or their privies, be taken as conclusively established, so long as the judgment in the first suit remains unmodified."

(Mass.) 206, 1829. Compare the following cases of former judgments taken upon the defendant's default: *Ellis v. Jameson*, 17 Maine 235; 1840. *Cragin v. Carleton*, 21 Maine 492; 1842. *St. Louis Mut. L. Ins. Co. v. Cravens*, 69 Missouri 72; 1878. *Eisenlord v. Clum*, 126 N. Y. 552, 559, 560; 1891. *Millard v. Adams*, 1 Misc. (N. Y.) 431; 1892. *Greenleaf: Evidence*, Volume 1, Sections 527a and 537; *Black: Judgments*, Second Edition, Section 608; *Freeman: Judgments*, Fourth Edition, Section 417a; 23 Cyc. 1288. By the weight of authority, however, it would seem that such former judgment can be qualified or explained or rebutted by other testimony: *Clark v. Irvin*, 9 Ohio 131; 1839. *Green v. Bedell*, 48 New Hampshire 546; 1869. *Schreiner v. High Ct. of F.*, 35 Ill. App. 576; 1890. *Crawford v. Bergen*, 91 Iowa 675; 1894. *Commonwealth v. Horton*, 9 Pickering (Mass.) 206; 1829. But see *Cragin v. Carleton*, 21 Maine 492; 1842.

¹ 168 U. S. 1, 48, 1897.

In the absence of express findings of fact and conclusions of law set forth in the judgment or decree in the Government suit, a private complainant, whose cause of action arises out of transactions constituting only a fraction of the Government's case, would seem likely to find great difficulty in establishing that this judgment or decree conclusively determined, or made *res adjudicata*, or estopped from dispute, as between the defendant and the Government, the issue of the legality of the particular transaction on which his cause of action is predicated.¹ And unless he can establish this, the judgment or decree in the Government suit would seem, under any reasonable view of section 5 of the Clayton Act, to be wholly unavailable as evidence to a private complainant in a suit against the defendant.

The constitutionality of the section was disputed in Congress; but the change from "conclusive" to "prima facie" has gone far to reduce the possibility that the section will be declared unconstitutional. .

Section 5 of the Clayton Act further provides:

"Whenever any suit or proceeding in equity or criminal prosecution is instituted by the United States to prevent, restrain, or punish violations of any of the anti-trust laws, the running of the statute of limitations in respect of each and every private right of action arising

¹ See *Richardson v. City of Boston*, 19 How. (U. S.) 263, 267-268; 1856. *Washington, Alexandria & Georgetown Steam-Packet Company v. Sickles, et al.*, 24 How. (U. S.) 333, 344-345; 1860. *Packet Company v. Sickles*, 5 Wall. (U. S.) 580, 590-592; 1866. *Cromwell v. County of Sac*, 94 U. S. 351; 1876. *Davis v. Brown*, 94 U. S. 423, 428-429; 1876. *Russell v. Place*, 94 U. S. 606, 608-610; 1876. *Stewart v. Lansing*, 104 U. S. 505, 510; 1881. *Nesbit v. Riverside Independent District*, 144 U. S. 610, 618-621; 1892. *Wilmington & Weldon Railroad v. Alsbrook*, 146 U. S. 279, 302; 1892. *McComb v. Frink*, 149 U. S. 629, 639-642; 1892. *Keokuk & Western Railroad Company v. Missouri*, 152 U. S. 301, 313-316; 1894. *De Sollar v. Hanscome*, 158 U. S. 216, 221-222; 1895. *Stone v. United States*, 167 U. S. 178, 184, 186-189; 1897. *New Orleans v. Citizens' Bank*, 167 U. S. 371, 389-400; 1897. *Dennison v. United States*, 168 U. S. 241, 249; 1897. *Southern Pacific Railroad Company v. United States*, 183 U. S. 519, 525, 528, 530, 432-534; 1902. *Lander v. Mercantile Bank*, 186 U. S. 458, 476-477; 1902. *Yates v. Utica Bank*, 206 U. S. 181, 183-184; 1907. *Virginia-Carolina Chemical Company v. Kirven*, 215 U. S. 252, 257-259; 1909. *Trozell v. Delaware, Lackawanna & Western Railroad Company*, 227 U. S. 434, 440-443; 1913.

under said laws and based in whole or in part on any matter complained of in said suit or proceeding shall be suspended during the pendency thereof."

The limitation of the effect of this provision to "any matter complained of in said suit or proceeding" raises the question as to whether the private cause of action is really based upon a matter complained of in the Government suit. Unless the particular transaction, on which the private cause of action in whole or in part is based, is specifically referred to in the bill or indictment in the Government suit, this question is almost as difficult as that raised by the preceding paragraph of section 5 hereinbefore discussed.

Upon the score of constitutionality, the provisions above quoted would seem to be unexceptionable.

Section 6 of the Clayton Act provides:

"That the labor of a human being is not a commodity or article of commerce. Nothing contained in the anti-trust laws shall be construed to forbid the existence and operation of labor, agricultural, or horticultural organizations, instituted for the purposes of mutual help, and not having capital stock or conducted for profit, or to forbid or restrain individual members of such organizations from lawfully carrying out the legitimate objects thereof; nor shall such organizations, or the members thereof, be held or construed to be illegal combinations or conspiracies in restraint of trade, under the anti-trust laws."

The word "lawfully" was added to this section in the Senate. This word, and the words "legitimate objects," import into this section all the qualifications and standards of all the anti-trust laws. Considered by itself, therefore, this section would not in the least alter the law as heretofore interpreted and enforced in respect of labor organizations. But in so far as other sections of the Clayton Act may have relaxed the law in respect of labor controversies, this section has clearly changed the law in respect of labor organizations. Considered, therefore, in the light of the discussion hereinafter of section 20, there may be concealed under the platitudinous language of section 6 a sub-

stantial relaxation of the Sherman Act as heretofore interpreted and enforced by the courts in respect of labor organizations.

Section 13 of the Clayton Act provides that subpoenas for witnesses in Government suits under the antitrust laws may run into any district, but that subpoenas for witnesses in civil suits shall not, without permission of the trial court, run more than 100 miles outside the district in which the court is held. "Under the existing law," said the Judiciary Committees of the House and the Senate, "subpoenas for witnesses in such suits run only in the district in which they are issued." This section, therefore, was enacted for the purpose of meeting this situation.

Section 15 of the Clayton Act closely follows the language of sections 4 and 5 of the Sherman Act in authorizing United States District Attorneys, under the direction of the Attorney General, to sue to restrain violations of the Clayton Act.

Section 16 of the Clayton Act changes the rule, expressed by the Supreme Court in *Minnesota v. Northern Securities Company*,¹ and enforced in other cases, that heretofore has restricted to the United States the right to sue for an injunction to restrain a violation of the Sherman Act. Except as against common carriers in respect of matters under the jurisdiction of the Interstate Commerce Commission, section 16 of the Clayton Act extends this right of suit for injunction, in respect of all the antitrust laws, to "any person, firm, corporation, or association."

The provisions of section 16 in respect of giving security against damages are explicit and apparently unambiguous. In connection with subsequent sections of the Clayton Act, however, they have given rise to a curious confusion.

Section 18 of the Clayton Act provides:

"That, except as otherwise provided in section 16 of this Act, no restraining order or interlocutory order of injunction shall issue, except upon the giving of security by the applicant in such sum as the court

¹ 194 U. S. 48; 1904.

or judge may deem proper, conditioned upon the payment of such costs and damages as may be incurred or suffered by any party who may be found to have been wrongfully enjoined or restrained thereby."

Section 16 of the Clayton Act, it will be recalled, relates to suits for injunction by private complainants. So far as preliminary injunctions are concerned, instead of providing any exception to the terms of section 18, section 16 substantially paraphrases the provisions of section 18 in respect of the giving of security.

Section 18, therefore, would appear to have changed the whole practice of restraining orders and interlocutory orders of injunction in Government suits, and to require now that the Government give security like a private complainant. Since no means exist by which the Government can do this, the consequence would seem to be that until machinery is created by which the Government may comply with the sweeping and apparently absolute requirements of section 18, the Government cannot obtain any restraining order or interlocutory order of injunction.

Section 15 of the Clayton Act provides that, in suits by the Government, "pending such petition and before final decree, the court may at any time make such temporary restraining order or prohibition as shall be deemed just in the premises." But since exemption from giving security is not expressly given by this section, and since section 18 is so sweeping and absolute in its terms, there is ground for contending that section 18 governs section 15, and that the provisions of the latter above quoted cannot be invoked until means are provided by which the Government may give security for any "restraining order or interlocutory order of injunction" that it may obtain.

In the only case that has thus far arisen on this point, however,¹ the United States obtained a temporary restraining order, and later a preliminary injunction, without giving any

¹ *United States v. United Shoe Machinery Company*, D. C., E. D., Missouri, 227 Fed. 507; 1915.

security whatsoever. But appeal is now pending from this preliminary injunction, and pending the appeal the defendants have obtained from the Circuit Court of Appeals a stay of the preliminary injunction by themselves filing a substantial bond.¹

III

Influenced apparently by the desire to meet criticisms long directed by organized labor against federal court injunctions, Congress included in the Clayton Act the substance of two bills² relating to injunctions and procedure in contempt cases, which had been favorably reported by the House Judiciary Committee and passed by the House in the preceding session.

Section 18, relating to injunction bonds, has already been discussed.

Section 17 provides that no preliminary injunction shall be granted without notice, and that, unless irreparable injury has been shown, no temporary restraining order shall be granted without notice.

Section 19 sets forth what specific allegations must be included in this injunction.

One court has apparently held that these provisions are not binding upon the Government, when it applies for a restraining order and a preliminary injunction in a Government suit under the Clayton Act.³ But appeal is now pending from this decision, and pending the appeal the defendants have obtained from the Circuit Court of Appeals a stay of the preliminary injunction by themselves filing a substantial bond.⁴

Section 20 prescribes the conditions under which injunctions shall be issued in cases between employer and employees. The

¹ Upon this appeal, decided May, 1916, this preliminary injunction was vacated; but the court did not discuss the point above mentioned.

² H. R. 26,635 and H. R. 22,591.

³ *United States v. United Shoe Machinery Company*, D. C., E. D., Missouri, 227 Fed. 507; 1915.

⁴ Upon this appeal, decided May, 1916, this preliminary injunction was vacated; but the court did not discuss the point above mentioned.

section follows the best preëxisting practice, in limiting injunctions to cases where they are

“necessary to prevent irreparable injury to property, or to a property right, of the party making the application, for which injury there is no adequate remedy at law, and such property or property right must be described with particularity in the application, which must be in writing and sworn to by the applicant or by his agent or attorney.”

But the section breaks new ground in its remaining provisions :

“And no such restraining order or injunction shall prohibit any person or persons, whether singly or in concert, from terminating any relation of employment, or from ceasing to perform any work or labor, or from recommending, advising, or persuading others by peaceful means so to do; or from attending at any place where any such person or persons may lawfully be, for the purpose of peacefully obtaining or communicating information, or from peacefully persuading any person to work or to abstain from working; or from ceasing to patronize or to employ any party to such dispute, or from recommending, advising, or persuading others by peaceful and lawful means so to do; or from paying or giving to, or withholding from, any person engaged in such dispute, any strike benefits or other moneys or things of value; or from peaceably assembling in a lawful manner, and for lawful purposes; or from doing any act or thing which might lawfully be done in the absence of such dispute by any party thereto; nor shall any of the acts specified in this paragraph be considered or held to be violations of any law of the United States.”

These provisions legalize, so far as federal law is concerned, transactions which may clearly be acts in the chain of a conspiracy in violation of the Sherman Act and, therefore, unlawful under the Sherman Act as heretofore interpreted and enforced by the courts. How far these provisions may prevent the courts, in the future, from holding to be in violation of the Sherman Act labor combinations of the character heretofore denounced as unlawful in *Loewe v. Lawlor*¹ and other cases will undoubtedly be a much litigated question.

¹ 208 U. S. 233; 1908.

Sections 21 and 22 provide that when the act contempt of an injunction constitutes also a criminal offense against a federal or state statute, the accused shall be tried by the court, or, upon demand of the accused, by a jury, and if found guilty shall be punished by fine or imprisonment or both.

Section 23 provides for a review of these proceedings in the manner heretofore provided in criminal cases, and for admission of the accused to bail.

Section 24 provides :

"That nothing herein contained shall be construed to relate to contempts committed in the presence of the court, or so near thereto as to obstruct the administration of justice, nor to contempts committed in disobedience of any lawful writ, process, order, rule, decree, or command entered in any suit or action brought or prosecuted in the name of, or on behalf of, the United States, but the same, and all other cases of contempt not specifically embraced within section twenty-one of this Act, may be punished in conformity to the usages at law and in equity now prevailing."

Section 25 fixes one year as the statute of limitations in contempt proceedings.

IV

The substantive provisions of the Clayton Act, relating to price discriminations, exclusive contracts, intercorporate stockholdings and interlocking directorships, have thus far proved the most controversial provisions of the act.

Section 2 of the Clayton Act provides :

"That it shall be unlawful for any person engaged in commerce, in the course of such commerce, either directly or indirectly to discriminate in price between different purchasers of commodities, which commodities are sold for use, consumption, or resale within the United States or any Territory thereof or the District of Columbia or any insular possession or other place under the jurisdiction of the United States, where the effect of such discrimination may be to substantially lessen competition or tend to create a monopoly in any line of commerce: *Provided*, That nothing herein contained shall prevent discrimination in price between purchasers of commodities on account of

differences in the grade, quality, or quantity of the commodity sold, or that makes only due allowance for difference in the cost of selling or transportation, or discrimination in price in the same or different communities made in good faith to meet competition: *And provided further*, That nothing herein contained shall prevent persons engaged in selling goods, wares or merchandise in commerce from selecting their own customers in *bona fide* transactions and not in restraint of trade."

Many causes contributed to the provisions above quoted.

By 1914, nineteen states had adopted statutes prohibiting price discriminations of one form or another, and most of these statutes had been enacted during the three years immediately preceding the passage of the Clayton Act. In cases arising under the federal and state antitrust acts, predatory price discriminations had repeatedly and specifically been denounced by the courts. In the proposed antitrust legislation advocated prior to the enactment of the Clayton Act by Congressman Lenroot, Senator La Follette and Congressman Stanley — all of which influenced strongly, though unconsciously, the legislative temper that directed the course of legislation in 1914, at least in its earlier stages — specific prohibitions against various kinds of price discrimination had a prominent place. So hard, however, was it found to take care of the legitimate exceptions to the general prohibition against price discriminations that the Senate voted to drop the section entirely. But the proposal already had too much popular strength, and argument to the effect that the generic provisions of the Sherman Act, and section 5 of the Federal Trade Commission Act forbidding unfair competition already reached every possible evil of price discrimination fell on deaf ears. The conference committee having charge of the Clayton bill, in deference to a very popular superstition, felt obliged to legislate expressly against price discriminations, and accordingly put back the section, with amendments, and with the section in the bill its report was finally adopted by the Senate as well as the House.

Section 3 of the Clayton Act provides :

"That it shall be unlawful for any person engaged in commerce in the course of such commerce, to lease or make a sale or contract for sale of goods, wares, merchandise, machinery, supplies or other commodities, whether patented or unpatented, for use, consumption or resale within the United States or any territory thereof or the District of Columbia or any insular possession or other place under the jurisdiction of the United States, or fix a price charged therefor, or discount from, or rebate upon such price on the condition, agreement or understanding that the lessee or purchaser thereof shall not use or deal in the goods, wares, merchandise, machinery, supplies or other commodities of a competitor or competitors of the lessor or seller, where the effect of such lease, sale or contract for sale or such condition, agreement or understanding may be to substantially lessen competition or tend to create a monopoly in any line of commerce."

Agitation against systems of limited licenses under patents, popularly associated with the United Shoe Machinery Company, the Motion Picture Patents Company, and some other concerns, and against various kinds of exclusive contracts and so-called "tying" contracts, that had been variously charged in several antitrust suits and that had led to legislation in Texas, Michigan, Massachusetts and some other states and to the reverberant dissenting opinion of Chief Justice White in *Henry v. A. B. Dick Co.*,¹ was probably responsible for the provisions above quoted.

Similar provisions had a prominent place in the proposals of Congressman Lenroot, Senator La Follette, and Congressman Stanley before the passage of the Clayton Act. Like the price discrimination section, however, the exclusive contract section was found, in the course of the Senate debate on section 5 of the Federal Trade Commission Act forbidding unfair competition, to be probably superfluous, in view of the Sherman Act and this section of the Federal Trade Commission Act. But while the Senate was willing to drop the price discrimination section, it clung to the exclusive contract section, and after wrestling with various statutes and amendments, the Senate

¹ 224 U. S. 1; 1912.

adopted the section which was amended and brought into its present form in conference and finally agreed to by the House and Senate.

Neither the price discrimination section nor the exclusive contract section have any operation except where their effect "may be to substantially lessen competition or tend to create a monopoly in any line of commerce."

At the outset, therefore, it must be determined what this phrase means.

In the prototype of these sections in Mr. Clayton's tentative bill Number 1, this phrase did not appear; but in tentative bill Number 4, where certain kinds of intercorporate stockholding were forbidden, there appear the words "where the effect of the acquisition is to eliminate or lessen competition between the corporation whose stock is so acquired and the corporation making the acquisition, or to create a monopoly of any line of trade in any section or community." This seems to mark the genesis of the phrase.

In the form in which it passed the House, these sections did not contain this phrase, nor anything that can fairly be called equivalent to it.

The words "may . . . create a monopoly in any line of commerce" have clearly the same meaning as the words "monopolize, or attempt to monopolize . . . any part of the trade or commerce," in the Sherman Act. But neither the phrase "substantially lessen competition," nor any corresponding language, appears in the Sherman Act.

The so-called antitrust provisions of the Wilson Tariff Act¹ referred to restraint of "competition" in a manner that might, perhaps, have been taken to be in contradistinction to "restraint of lawful trade." Section 73 provides:

"That every combination . . . or contract is hereby declared to be . . . illegal, and void, when the same is made by or between two or more persons or corporations either of whom is engaged in import-

¹ U. S. 28 Stat. L., 570, August 27, 1894, Chap. 349.

ing any article from any foreign country into the United States, and when such combination, conspiracy, trust, agreement, or contract is intended to operate in restraint of lawful trade, or *free competition* in lawful trade or commerce. . . ." (*italics mine*)

This section was expressly preserved in the Dingley Tariff Act.¹

The section above quoted was amended in 1913² by inserting after the words "corporations either of whom" the words "as agent or principal."

The foregoing section appears never to have been judicially construed. Whether restraint of "competition," in this section, is intended to be anything different from "restraint of lawful trade" is, therefore, at best doubtful.

Language corresponding somewhat to the phrase "substantially lessen competition" appears in the antitrust statutes of many of the states. Among them may be mentioned Alabama, Arizona, Arkansas, California, Colorado, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Massachusetts, Michigan, Minnesota, Mississippi,³ Missouri,⁴ Montana, Nebraska, New Jersey, New Mexico, New York, North Carolina, North Dakota, Ohio, Oklahoma, South Carolina, South Dakota,⁵ Tennessee, Texas, Utah, Wisconsin and Wyoming. Examination of the decisions construing the statutes of these various states tends to support the view that phrases therein, which may fairly be called comparable to the phrase "substantially lessen competition," are simply the equivalents of "restraint of trade or commerce" and "monopolize, or attempt to monopolize," as those phrases in the Sherman Act have been interpreted and enforced by the Supreme Court of the United States. Cases tending to support this proposi-

¹ 30 U. S. Stat. L., 213, Sec. 34.

² Act of February 12, 1913, Chap. 370.

³ See especially *Grenada Lumber Company v. Mississippi*, 217 U. S. 433; 1910.

⁴ See especially *International Harvester Company v. Missouri*, 234 U. S. 199; 1914.

⁵ See especially *Central Lumber Company v. South Dakota*, 226 U. S. 157; 1912.

tion may be found in Alabama, Georgia, Indiana, Michigan, Minnesota, Mississippi, Missouri, Nebraska, New Jersey, New York, Ohio, South Carolina, and Tennessee. Cases deserving attention because of their apparent disagreement with this view, but which appear, upon analysis, to be probably distinguishable may be found in Kansas¹ and Texas.²

Examination of the decisions under the Sherman Act affords further confirmation of the view that the words "substantially lessen competition" are only a paraphrase for the words "restraint of trade or commerce" and "monopolize, or attempt to monopolize."

Contracts and acts that "substantially lessen competition" have repeatedly been held to be in violation of the Sherman Act. Thus the Sherman Act has been held by the Supreme Court to forbid

an "agreement" that "does in fact prevent competition" though perhaps it "purports to *restrain competition* . . . in a very slight degree and on a single point";³

"any contract . . . where the natural and direct effect of such a contract will be, when carried out, to directly, and not as a mere incident to other and innocent purposes, regulate to *any substantial extent* interstate commerce";⁴

"contracts which directly and *substantially*, and not merely indirectly, remotely, incidentally and collaterally, regulate to a *greater or less degree* commerce among the several states";⁵

"contracts which would directly and *substantially* and not as a mere incident regulate interstate commerce";⁶

an agreement that "directly effects a restraint of interstate commerce" though "it does not amount to one per cent of the business of the dealers in tiles in that city";⁷

¹ See especially *Smiley v. Kansas*, 196 U. S. 447; 1905.

² See especially *National Cotton Oil Company v. Texas*, 197 U. S. 115; 1905; and *Waters-Pierce Oil Company v. Texas*, 212 U. S. 86; 1909.

³ *United States v. Joint Traffic Association*, 171 U. S. 505, 575; 1898 (italics mine).

⁴ *Addyston Pipe and Steel Co. v. United States*, 175 U. S. 211, 228; 1900 (italics mine).

⁵ *Ibid.*, p. 229 (italics mine).

⁶ *Ibid.*, p. 229 (italics mine).

⁷ *Montague & Company v. Lowry*, 193 U. S. 38, 46; 1904.

"any combination which by its necessary operation destroys or *restricts free competition* among those engaged in interstate commerce";¹ acts "which operated to the prejudice of the public interests by *unduly restricting competition* or unduly obstructing the due course of trade";² acts which "injuriously restrained trade";³

"destroying or greatly abridging the free operation of *competition* theretofore existing", even though "this competitive traffic was infinitesimal when compared with the gross amount of the business transacted by both roads" and "a comparatively small part of the sum total of all traffic, state and interstate carried over them" because apparently, in this case, "it was by no means a negligible part but a large and valuable part, of interstate commerce which was thus directly affected" and "was in a *substantial* part the subject matter of rivalry and competition between these two systems";⁴

a "concerted scheme" that operates "to *unduly suppress competition* and restrain freedom of commerce among the States";⁵

a combination whose "necessary result is *materially* to restrain trade between the States";⁶

an arrangement that "affords evidence of an intent to suppress that competition and of a purpose to *unduly restrain the freedom of production, transportation and sale* of the product at tide-water markets";⁶

"artificial conditions, which necessarily impede or burden the due course of such trade or commerce or *restrict the common liberty to engage therein*";⁷

"only such contracts and combinations . . . as by reason of intent or the inherent nature of the contemplated acts prejudice the public interests by *unduly restricting competition* or *unduly obstructing the course of trade*";⁸

combinations "*unduly restrictive of the flow of commerce* or *unduly restrictive of competition*";⁹

¹ *Northern Securities Company v. United States*, 193 U. S. 197, 337; 1904 (italics mine).

² *United States v. American Tobacco Co.* 221 U. S. 106, 179; 1911 (italics mine).

³ *Ibid.*, 179 (italics mine).

⁴ *United States v. Union Pacific Railroad Company*, 226 U. S. 61, 88-89; 1912 (italics mine).

⁵ *United States v. Reading Company*, 226 U. S. 324, 369; 1913 (italics mine).

⁶ *Ibid.*, 370 (italics mine).

⁷ *United States v. Patten*, 226 U. S. 525, 541; 1913 (italics mine).

⁸ *Nash v. United States*, 229 U. S. 373, 376; 1913 (italics mine).

⁹ *Eastern States Retail Lumber Dealers Association v. United States*, 234 U. S. 600, 610; 1914 (italics mine).

"practices which *unduly restrain competition or unduly obstruct the free flow of such commerce*";¹

acts which "*unduly suppress competition*";²

acts "which were *unreasonably restrictive of competitive conditions*";³

That the standard of legality set up in the Clayton Act by the words "substantially lessen competition" is none other than the standard established by the Sherman Act in the words "restraint of trade or commerce" and "monopolize, or attempt to monopolize" is the view of practically every authority thus far expressed.

Thus in *Great Atlantic & Pacific Tea Company v. Cream of Wheat Company*⁴ Judge Hough declared that

"there is nothing in the Clayton Act to compel or induce courts to hold that the trade restraint referred to by this statute differs in kind, quality, or degree from that now held to be meant by the Sherman Act. . . . Section 2 plainly identifies the lessening of competition with restraint of trade."

Similarly, Ex-President Taft in his Address before the Annual Meeting of the American Bar Association, on October 2, 1914, stated:

"The words 'with the effect substantially to lessen competition' are to be construed in the light of their association with the words that follow them in order to secure some guide to the meaning of 'substantially.' It certainly does not mean any lessening of competition, however small, because its ordinary signification prevents that. . . . The only reasonable solution would seem to be to hold that it means such substantial suppression of competition as to constitute a real restraint of trade and a tendency to monopolize."

Against this view, however, two considerations are likely to be urged:

First, that the sponsors in Congress of the Clayton bill undoubtedly intended and believed, and repeatedly stated, that its substantive provisions go further than the Sherman Act.

¹ *Ibid.*, 613 (italics mine).

² *Ibid.*, 614 (italics mine).

³ *Standard Oil Co. v. United States*, 221 U. S. 1, 58; 1911 (italics mine).

⁴ 224 Fed. 566, 573; 1915; affirmed. 227 Fed. 46; 1915.

Second, that if Congress had intended by the phrase "substantially lessen competition" to set up merely the legal standard of the Sherman Act, it would have used the language of the Sherman Act, viz., "restraint of trade or commerce" and "monopolize, or attempt to monopolize," instead of painfully evolving new language.

The first proposition was clearly expressed by the Senate Judiciary Committee in its report upon the Clayton Act:

"It is well, at the outset, to state the theory of the bill, both as it passed the House of Representatives and as it is proposed to be amended, for the general scope of the House measure is unchanged. It is not proposed by the bill or amendments to alter, amend, or change in any respect the original Sherman Anti-trust Act of July 2, 1890. The purpose is only to supplement that act and the other anti-trust acts referred to in section 1 of the bill. Broadly stated, the bill, in its treatment of unlawful restraints and monopolies, seeks to prohibit and make unlawful *certain trade practices which, as a rule, singly and in themselves, are not covered by the act of July 2, 1890 or other existing anti-trust acts*, and thus, by making these practices illegal, to arrest the creation of trusts, conspiracies, and monopolies in their incipency and before consummation. Among other of these trade practices which are denounced and made unlawful may be mentioned discrimination in prices for the purpose of wrongfully injuring or destroying the business of competitors, exclusive and tying contracts, holding companies, and interlocking directorates" (*italics mine*).

This view, both before and after the bill had assumed the form of the present Clayton Act, was repeatedly expressed on the floor of Congress by sponsors of the bill.

This view, however, seems pretty satisfactorily disposed of by the fact that when the Clayton Act was passed, Congress, as appears from the debates, was under a general misapprehension that the Sherman Act had proved insufficient to cover "substantial lessening of competition," and therefore believed that language different from the Sherman Act was needed in order to accomplish the result, which, unperceived by Congress, the Sherman Act had already accomplished.

The second proposition depends upon the familiar rule of statutory construction that interpretations supported only by elaborate inference and argument are not favored by the courts when, in the opinion of the courts, it would have been easy for the legislature to have explicitly expressed such meaning. This rule, expressed in the maxim "it would have been easy to say so," has been repeatedly applied by the Supreme Court.

Applying now this rule to the Clayton Act and the Sherman Act :

Examination of the phrase "substantially lessen competition," in sections 2 and 3 of the Clayton Act, in comparison with the analogous phrases in section 7, develops the fact that in section 7, relating to intercorporate stockholding, the phrases used are "*substantially lessen competition between the corporation whose stock is so acquired and the corporation making the acquisition*" and "*substantially lessen competition between such corporations, or any of them, whose stock or other share capital is so acquired.*"

This shows that Congress had no intention, in the phrase "substantially lessen competition" to mean *substantially lessen competition simply between any two concerns*. The fact that "it would have been easy to say so," and the further fact that in section 7 Congress *did* say so, conclusively establish this proposition.

But the maxim "it would have been easy to say so" does not, however, go to the extent of proving that "substantially lessen competition" necessarily means something different from "restraint of trade or commerce" and "monopolize, or attempt to monopolize," in the Sherman Act. For when the Clayton Act was passed, Congress, as appears from the debates, misapprehended the effect of the Sherman Act, and erroneously believed that it did not cover "substantial lessening of competition," and therefore deemed it necessary to select language different from the Sherman Act in order to accomplish the result, which, unperceived by Congress, the Sherman Act had already accomplished.

Several other clauses in the price discrimination section raise questions of interpretation:

Does the exemption of discriminations "made in good faith to meet competition" depart from the standards of legality set up in the Sherman Act?

Probably not, according to the rule laid down in *Patterson v. United States*¹ and in the charge of Judge Rellstab to the jury in *Buckeye Powder Company v. E. I. du Pont de Nemours Powder Company*,² and in some of the decrees entered upon consent in Government suits under the Sherman Act. But the point is not altogether clear.

Does the proviso that "nothing herein contained shall prevent persons engaged in selling goods, wares or merchandise in commerce from selecting their own customers in *bona fide* transactions and not in restraint of trade" lay down an exception to the Sherman Act?

In *Great Atlantic & Pacific Tea Company v. Cream of Wheat Company*,³ Judge Hough, discussing this section and particularly this clause said:

"Section 2 plainly identifies the lessening of competition with restraint of trade. (Cf. the body of the section with the last exception.) But price discrimination is only forbidden when it 'substantially' lessens competition. Construing the whole section together, the last exception reads in effect that a 'vendor may select his own *bona fide* customers providing the effect of such selection is not to *substantially* and *unreasonably* restrain trade.'"

Judge Hough's conclusion in this case, that the Cream of Wheat Company could not be restrained from refusing to sell to the Great Atlantic & Pacific Tea Company, because the latter was cutting the retail price of Cream of Wheat, hardly depends, therefore, upon this proviso of section 2. But it suggested, perhaps, the line taken by Judge Hough in the following much quoted passage of this decision:

¹ 222 Fed. 599, 650 (C. C. A. 6th C. March 13, 1915).

² D. C. N. J., Feb. 1914, unreported, affirmed 223 Fed. 881; 1915.

³ 224 Fed. 566, 574; 1915.

"How it can be called substantial and unreasonable restraint of trade to refuse to deal with a man who avowedly is to use his dealing to injure the vendor, when said vendor makes and sells only such an advertisement begotten article as Cream of Wheat, whose fancy name needs the nursing of carefully handled sales to maintain an output of trifling moment in the food market, is beyond my comprehension. . . .

"If it be granted that section 2 does apply, and that defendant's selection of customers results in unlawful restraint of trade, can it be possible that such person's evil ways are to be amended, not by stopping his business, but by adding to his list of customers one or many persons chosen by Congress? Numerous individuals and corporations have been enjoined from restraining the trade of other people, no matter how flourishing the offenders' trade might be, nor how greatly the general volume of trade had increased during the period of restraint. But never before has it been urged that, if J. S. made enough of anything to supply both Doe and Roe, and sold it all to Doe, refusing even to bargain with Roe, for any reason or no reason, such conduct gave Roe a cause of action."

The same proviso, perhaps, contributed to the vigor of Judge Lacombe's language¹ in the opinion of the Circuit Court of Appeals affirming Judge Hough's decision.

"We had supposed that it was elementary law that a trader could buy from whom he pleased and sell to whom he pleased and that his selection of seller and buyer was wholly his own concern. 'It is a part of a man's civil rights that he be at liberty to refuse business relations with any person whomsoever, whether the refusal rests upon reason, or is the result of whim, caprice, prejudice or malice.' *Cooley on Torts*, p. 278. See also our own opinion in *Greater New York Film Company v. Biograph Company*, 203 Fed. 39; 1913. Before the Sherman Act it was the law that a trader might reject the offer of a proposing buyer, for any reason that appealed to him: — It might be because he did not like the other's business methods, or because he had some personal difference with him, political, racial or social. That was purely his own affair with which nobody else had any concern. Neither the Sherman Act, nor any decision of the Supreme Court, construing the same, nor the Clayton Act has changed the

¹ *Great Atlantic & Pacific Tea Company v. Cream of Wheat Company*, 227 Fed. 46, 49, C.C.A. 2d C. November 10, 1915.

law in this particular. We have not yet reached the stage, where the selection of a trader's customers is made for him by the government."

Although advanced ground in denial of the right to refuse to deal with a prospective customer under circumstances similar to the foregoing has repeatedly been taken by the Department of Justice in investigations relating to complaints under the Sherman Act, it is noteworthy that in proceedings thus far commenced under the Sherman Act the Department has denied this right only in cases where it has been alleged that there also existed an *actual agreement* to maintain prices or to do other things that in themselves were more colorably in violation of the Sherman Act. It may be doubted, therefore, whether this proviso in any way alters the rule established by the Sherman Act.

Disposition exists in some quarters to regard section 2 of the Clayton Act as somehow relaxing the rule of the Sherman Act in respect of price discriminations. That this would be the result, if the standards of legality set up in this section were lower than those of the Sherman Act, would seem to be clear, under the well-settled rule that a subsequent special statute (viz. the Clayton Act), following a prior general statute (viz. the Sherman Act) and in any respect inconsistent therewith, supersedes in respect of all inconsistent provisions the prior general statute. Taking section 2 altogether, therefore, in the light of all the foregoing considerations, it seems probable that it merely paraphrases, without any substantial change whatsoever, the Sherman Act in its application to price discriminations.

Section 3 of the Clayton Act, relating to exclusive contracts, becomes operative, like the price discrimination section, only where the effect of the "lease, sale, or contract for sale or such condition, agreement or understanding may be to substantially lessen competition or tend to create a monopoly in any line of commerce." For the reasons above set forth, there-

fore, such arrangements would seem to be lawful, unless they offend against the standards of legality already established by the Sherman Act.

Some have contended that the inclusion in this section of patented, as well as unpatented, commodities extends the law beyond the area covered by the Sherman Act.

This view appears to rest upon one or the other of two popular misconceptions:

First, the popular misconception regarding the extent to which the Sherman Act, in its relation to patented articles, already forbids many arrangements, that formerly were thought to be included within the patent protection, but latterly have been held to be outside; and

Second, the popular misconception regarding the extent to which the patent laws, within the legitimate scope of their operation, prevent the courts, upon clear constitutional grounds, from indulging the inference that Congress intended to amend the patent laws.

The materials for the correction of these two popular misconceptions exist in several recent decisions of the Supreme Court and the lower federal courts, and need not here be discussed.¹ But it is confidently believed that they amply support the proposition that, so far as patented articles are concerned, the rule established by the Sherman Act has not been altered by section 3 of the Clayton Act.

Section 3 of the Clayton Act provides that it shall be unlawful to lease, sell, or contract to sell, or fix a price, discount or rebate upon "the condition, agreement, or understanding that the lessee or purchaser thereof shall not use or deal in the goods, wares, merchandise, machinery, supplies or other commodities of a competitor or competitors of the lessor or seller."

¹ See especially *Standard Sanitary Manufacturing Co. v. United States*, 226 U. S. 20; 1913. *Virtue v. Creamery Package Co.*, 227 U. S. 8; 1913. *Winslow v. United States*, 227 U. S. 202; 1913. *Blount Manufacturing Co. v. Yale & Towne Manufacturing Co.*, 166 Fed. 555; 1908. *United States v. United Shoe Machinery Company*, 222 Fed. 349; 1915.

Literally, this language makes the section operative only when the customer is denied absolutely all freedom to "use or deal in" a competitor's goods. Where, as in *Henry v. A. B. Dick Co.*¹ therefore, the notice on the mimeograph provided that "this machine is sold by the A. B. Dick Company with the lessee's restriction that it may be used only with the stencil paper, ink and other supplies made by A. B. Dick Company," it would follow that since the customer was not denied absolutely all freedom to use a competitor's stencil paper, ink and other supplies, but was merely forbidden to use them on the Dick machine, and was, therefore, left free to use them in any other way, the notice would not fall within this clause of the section, and would, therefore, be entirely outside the prohibition of the law.

If this be the interpretation of the section — and its literal language plainly suggests it — then most of the arrangements that have furnished the inspiration for this section plainly fall wholly outside it.

In several investigations now pending in the Department of Justice and the Federal Trade Commission, and in a suit which the Government has recently begun under this section² the Government's view appears to be that this clause means any "condition, agreement, or understanding" which, in the slightest degree, denies to the customer any part of his entire freedom to "use or deal in" a competitor's goods.

But this construction can hardly be possible.

A competitor's machinery, to illustrate, may be capable of four practical uses — A, B, C and D. The condition, agreement or understanding may, in effect, prevent use D, and leave uses A, B and C intact to the lessees. Can it be contended that a "condition, agreement or understanding" that *leaves to the lessee all these uses* of the competitor's machinery is a "condi-

¹ 224 U. S. 1; 1912.

² *United States v. United Shoe Machinery Company*, D. C. E. D., Missouri, 227 Fed. 507; 1915; upon appeal, decided May, 1916, this preliminary injunction was vacated.

tion, agreement or understanding *that the lessee . . . shall not use . . . the . . . machinery . . . of a competitor . . . of the lessor . . . ?*"

Such a contention would involve a clear distortion of the statute.

A competitor's goods may be capable of being used or dealt in by the customer in many different ways.

The customer may "use or deal in" them anywhere, anyhow, and any time; or he may "use or deal in" them only in specified places, or in a specified manner, or under specified conditions, or within specified periods.

The customer may "use or deal in" a competitor's goods unconditionally and with absolute freedom; or he may be forbidden to "use or deal in" them within a particular territory, or in a particular manner, or in connection with a particular plant or machine or under certain specified conditions, or during a particular period.

Take other illustrations:

The arrangement may simply forbid the dealer to "use or deal in" a competitor's goods in preference to the seller's goods. The prohibition of the section would hardly apply to this case; for the dealer is still permitted to "use or deal in" the competitor's goods to any degree he desires, short of giving them the preference over the selling goods.

Again: The arrangement may forbid the dealer to push the sale of a competitor's goods as hard as he pushes the sale of a seller's goods. The prohibition of the section would hardly apply to this case; because the dealer is still permitted to "use or deal in" the competitor's goods, provided he does not push their sale as hard as he pushes the seller's goods.

Selection and predilection, within limitations prescribed by the Sherman Act and the Clayton Act, are still legitimate factors in trade relations. So long as customers and dealers are left any reasonable degree of practical freedom, there would seem to be no violation of section 3 of the Clayton Act.

A medium course in construing this clause of section 3 would be to construe it as meaning any "condition, agreement or understanding" which in fact denies to the customer *substantially all practical freedom* to "use or deal in" a competitor's goods.

But even these limited classes of arrangements, it is submitted, are forbidden by section 3 of the Clayton Act only when they tend to restrain trade or monopolize, or attempt to monopolize within the meaning of the Sherman Act. The conclusion follows, therefore, that this section simply reaffirms the rule of the Sherman Act in respect of exclusive contracts.

In *Elliott Machine Co. v. Center*¹ a lease made before the passage of the Act was held to be in violation of this section. The opinion, however, did not discuss any of the points hereinbefore considered, and can hardly be regarded as really an authority against any of them.

Section 7 of the Clayton Act provides:

"That no corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital of another corporation engaged also in commerce, where the effect of such acquisition may be to substantially lessen competition between the corporation whose stock is so acquired and the corporation making the acquisition, or to restrain such commerce in any section or community, or tend to create a monopoly of any line of commerce.

"No corporation shall acquire, directly or indirectly the whole or any part of the stock or other share capital of two or more corporations engaged in commerce where the effect of such acquisition, or the use of such stock by the voting or granting of proxies or otherwise, may be to substantially lessen competition between such corporations, or any of them, whose stock or other share capital is so acquired, or to restrain such commerce in any section or community, or tend to create a monopoly of any line of commerce."

Several writers have suggested that these provisions have merely adopted the standard of legality in respect of intercorporate stockholding established by the Sherman Act.

¹ 227 Fed. 124; 1915.

If the words "between the corporation whose stock is so acquired and the corporation making the acquisition," and the words "between such corporations, or any of them, whose stock or other share capital is so acquired" had been omitted from these provisions, this view would seem sound. But with these words in the section, it appears, for reasons hereinbefore stated, that a standard of legality much stricter than the Sherman Act has here been established.

How much stricter it is difficult to say.

No one familiar with negotiations for the simultaneous acquisition of several incorporated businesses can fail to see what an obstacle this provision places in the way of combinations that would clearly be permissible under the Sherman Act. Several recent decisions have plainly indicated that combinations of competitors into a single business unit, that can insure economies of operation, and efficiency in competition, without threatening any domination of the market, are not in violation of the Sherman Act.¹ Public policy, indeed, would seem actually to favor such combinations, particularly in any industry where to-day a single large concern overshadows all competitors. But so long as this section requires a combination to be effected through purchase of plants and property, instead of through acquisition of stock control, the difficulties of combining small competitors into units large enough to compete, on equal terms, with the biggest concern in the industry are greatly accentuated.

By the remaining clauses of the section, corporations are permitted to acquire stock for investment and to create subsidiary corporations for carrying on legitimate branches of their business; and carriers are permitted to acquire stock in branch lines; and all acquisitions of stock lawfully acquired before the passage of the Clayton Act are excluded from its operation.

Section 8 of the Clayton Act provides that after two years from the passage of the Act

¹ See *United States v. United Shoe Machinery Co.*, 222 Fed. 349; 1911. *United States v. United States Steel Corporation*, 223 Fed. 55; 1912.

"no person shall at the same time be a director or other officer or employee of more than one bank, banking association or trust company, organized or operating under the laws of the United States, either of which has deposits, capital, surplus, and undivided profits aggregating more than \$5,000,000; and no private banker or person who is a director in any bank or trust company, organized and operating under the laws of a state, having deposits, capital, surplus, and undivided profits aggregating more than \$5,000,000, shall be eligible to be a director in any bank or banking association organized or operating under the laws of the United States."

Section 8 further provides :

"No bank, banking association or trust company, organized or operating under the laws of the United States, in any city or incorporated town or village of more than two hundred thousand inhabitants, as shown by the last preceding decennial census of the United States, shall have as a director or other officer or employee any private banker or any director or other officer or employee of any other bank, banking association or trust company located in the same place: *Provided*: That nothing in this section shall apply to mutual savings banks not having a capital stock represented by shares: *Provided further*, That a director or other officer or employee of such bank, banking association, or trust company may be a director or other officer or employee of not more than one other bank or trust company organized under the laws of the United States or any State where the entire capital stock of one is owned by stockholders in the other; *And provided further*, That nothing contained in this section shall forbid a director of class A of a Federal reserve bank, as defined in the Federal Reserve Act from being an officer or director or both an officer and director in one member bank."

This later provision has been construed by the Federal Reserve Board and the Department of Justice to be operative, like the preceding provision above quoted, only after two years from the passage of the Act.

To the clause above quoted there was added, by amendment on May 15, 1916, this further clause: "*And provided further*, That nothing in this Act shall prohibit any officer, director, or employee of any member bank or class A director of a Federal reserve bank, who shall first procure the consent of the Federal Reserve Board, which board

is hereby authorized, at its discretion, to grant, withhold, or revoke such consent, from being an officer, director, or employee, of not more than two other banks, banking associations, or trust companies, whether organized under the laws of the United States or any State, if such other bank, banking association, or trust company is not in substantial competition with such member bank. The consent of the Federal Reserve Board may be procured before the person applying therefor has been elected as a class A director of a Federal reserve bank or as a director of any member bank."

The figures and provisos set forth in these provisions portray the illogicality of this class of legislation.

Section 8 further provides :

"That from and after two years from the date of the approval of this Act no person at the same time shall be a director in any two or more corporations, any one of which has capital, surplus, and undivided profits aggregating more than \$1,000,000 engaged in whole or in part in commerce, other than banks, banking associations, trust companies and common carriers subject to the Act to regulate commerce, approved February fourth, eighteen hundred and eighty-seven, if such corporations are or shall have been theretofore, by virtue of their business and location of operation, competitors, so that the elimination of competition by agreement between them would constitute a violation of any of the provisions of any of the anti-trust laws."

This appears to forbid interlocking directorships between corporations, of the size specified, only when an agreement between such corporations not to compete would constitute a violation of the Sherman Act.

Section 10 of the Clayton Act provides elaborate regulation for dealings and contracts with carriers relating to securities, supplies, construction, and maintenance, to the amount of more than \$50,000 in the aggregate in any one year,

"when the said common carrier shall have upon its board of directors or as its president, manager or as its purchasing or selling officer, or agent in the particular transaction, any person who is at the same time a director, manager, or purchasing or selling officer, of, or who has any substantial interest in such other corporation, firm, partnership or association. . . ."

In this, as in the section just before discussed, there seems to be nothing to prevent a director of a holding company, lawfully holding stock in its subsidiary companies but itself not carrying on any business, from serving as director in any company competing with one of such subsidiaries, or in any railroad dealing with any such subsidiaries. But in so far as the holding company actively carries on business, or actively supervises or participates in the dealings and contracts of its subsidiaries with their customers, there is ground for the apprehension that these sections may possibly apply, upon the analogy of the decision in the second *Commodities Clause Case*,¹ and some of the cases which have followed it.²

Other clauses of the Clayton Act, regarding eligibility, competitive bidding, embezzlement, personal liability, and various provisos, need not here detain us.

V

The Federal Trade Commission was created by the Federal Trade Commission Act and consists of five commissioners. The Commission succeeded to the powers, proceedings, and office personnel and equipment of the old Bureau of Corporations. It has jurisdiction over every corporation engaged in interstate or foreign commerce, and it is authorized, among other things,

"(a) To gather and compile information concerning, and to investigate from time to time the organization, business, conduct, practices, and management of any corporation engaged in commerce, excepting banks and common carriers subject to the Act to regulate commerce, and its relation to other corporations and to individuals, associations, and partnerships.

"(b) To require, by general or special orders, corporations engaged in commerce, excepting banks, and common carriers subject to the

¹ *U. S. v. Lehigh Valley R. R. Co.*, 220 U. S. 257; 1911.

² See *U. S. v. Delaware, Lackawanna & Western R. R. Company*, 238 U. S. 516; 1915. *Hocking Valley R. R. v. N. Y. Coal Co.*, 207 Fed. 727; 1913 (C. C. A. 6th C.). *U. S. v. Reading Company*, 226 Fed. 229; 1915 (D. C. E. D. Pennsylvania).

Act to regulate commerce or any class of them, or any of them, respectively, to file with the commission in such form as the commission may prescribe annual or special, or both annual and special, reports or answers in writing to specific questions, furnishing to the commission such information as it may require as to the organization, business, conduct, practices, management, and relation to other corporations, partnerships, and individuals of the respective corporations filing such reports or answers in writing. Such reports and answers shall be made under oath, or otherwise, as the commission may prescribe, and shall be filed with the commission within such reasonable period as the commission may prescribe, unless additional time be granted in any case by the commission. . . .

"(f) To make public from time to time such portions of the information obtained by it hereunder, except trade secrets and names of customers, as it shall deem expedient in the public interest; and to make annual and special reports to the Congress and to submit therewith recommendations for additional legislation; and to provide for the publication of its reports and decisions in such form and manner as may be best adapted for public information and use.

"(g) From time to time to classify corporations and to make rules and regulations for the purpose of carrying out the provisions of this Act."

Other departments and bureaus of the Government, when directed by the President, must furnish to the Commission all records, papers, and information in their possession relating to any corporation subject to the Act, and must detail such officials and employees to the Commission as the President may direct.

For all purposes of the Act, the Commission is given

"access to, for the purpose of examination, and the right to copy any documentary evidence of any corporation being investigated or proceeded against; and the commission shall have power to require by subpoena the attendance and testimony of witnesses and the production of all such documentary evidence relating to any matter under investigation."

The Commission may compel the attendance of witnesses and the production of documentary evidence, and disobedience

to its subpoenas and orders in this regard is punishable as for contempt in the federal courts. Documentary evidence is defined to include "all documents, papers, and correspondence in existence at and after the passage of this act." Falsification of reports required by the Commission and any falsification, willful omission, willful mutilation, or removal of any such documentary evidence is punishable by fine and imprisonment.

Doubtless there is a line of privacy beyond which these tremendous investigatory powers cannot constitutionally be exercised by the Commission.¹ Notwithstanding the disabilities of corporations it is believed that some limitation must be implied upon these sweeping provisions. In *Harriman v. Interstate Commerce Commission*² the Supreme Court dealt with an individual, not a corporation; but in this case, and in others therein cited, there would seem to be authority for the view that even corporations might have some relief against the fullest exercise of these tremendous powers.

Under the Bureau of Corporations³ and thus far under the Commission, this question has happily been academic. But with the increased duties of the Commission it may at any time become exceedingly practical.

The Commission also has power to investigate the manner in which decrees in Government antitrust suits are being carried out; and under direction of the President or Congress, to investigate and report the facts regarding alleged violations of the antitrust laws; and under direction of the Attorney-General to investigate and make recommendations for the readjustment of any corporate business alleged to be violating the antitrust laws; and under direction of the courts to act as Master in Chancery to ascertain and report an appropriate form of decree of dissolution. Passing reference to these last two powers has been made in two recent decisions under the

¹ See *Hale v. Henkel*, 201 U. S. 75; 1906.

² 211 U. S. 407; 1909.

³ See *United States v. Armour*, 142 Fed. 808, 812; 1906.

antitrust laws, but no directions thereunder appear as yet to have resulted.¹

The Commission also has power

“(h) To investigate, from time to time, trade conditions in and with foreign countries where associations, combinations, or practices of manufacturers, merchants, or traders, or other conditions, may affect the foreign trade of the United States, and to report to Congress thereon, with such recommendations as it deems advisable.”

Recommendations, following an investigation recently made under this provision, are promised by the Commission for the near future.

Section 5 of the Federal Trade Commission Act provides that “unfair methods of competition in commerce are hereby declared unlawful.”

Behind these words lies a field of litigation which will probably prove as wide and hard-fought as the Sherman Act.

In the Trade Commission bill, as reported to the Senate by Senator Newlands, Chairman of the Senate Interstate Commerce Committee, the words “unfair competition” were used instead of “unfair methods of competition.”

In the Senate debate upon this section — which in duration, acuteness, and research did justice to the best traditions of the Senate — a number of definitions of “unfair competition” were ventured by sponsors of the bill.²

Senator Newlands’ definition included

Substantially all violations of the antitrust laws, including even wrongs arising from interlocking directorates and intercorporate relationships.

¹In *U. S. v. Corn Products Refining Company* (D. C. S. D. N. Y., decided June 24, 1916, not yet reported) Judge Learned Hand has since made such a direction.

²This debate I have summarized elsewhere in my article entitled “Unfair Methods of Competition,” *Yale Law Journal*, vol. XXV, No. 1, pp. 20-41, November, 1915, from which I have abstracted the various definitions herein-after discussed. The references in the footnotes of that article to the pages of the Congressional Record refer to the temporary and not the permanent paging of the Congressional Record.

All other acts affecting a competitor, for which any remedy "lies either at law or in equity."

All other acts affecting a competitor that are "against public morals," though heretofore quite lawful and not forbidden by the Sherman Law or any other law.

Senator Cummins' definition was

"Imposture," or any "vicious practice or method . . . that has a tendency to affect the people of the country or to be injurious to their welfare," though heretofore quite lawful under the Sherman Law.

Senator Robinson's definition was

The act of passing off one's business or goods for another's.

"Unfair competition" from an economic point of view.

All other acts which "normal business men" might deem inconsistent with "efficiency in producing and in selling."

Senator Robinson elaborated his definition as follows:

"Mr. William S. Stevens, of Columbia University, in an article called to my attention by Congressman Stevens, of New Hampshire, who introduced this provision in the House, discusses the subject of 'unfair competition' from an economic point of view, and classifies according to their elementary characteristics 11 forms of 'unfair competition' as follows: I read now from his article on page 283 of the *Political Science Quarterly* for June, 1914:

- "1. Local price cutting.
- "2. Operations of bogus 'independent' concerns.
- "3. Maintenance of 'fighting ships' and 'fighting brands.'
- "4. Lease, sale, purchase, or use of certain articles as a condition of the lease, sale, purchase, or use of other required articles.
- "5. Exclusive sales and purchase arrangements.
- "6. Rebates and preferential contracts.
- "7. Acquisition of exclusive or dominant control of machinery or goods used in the manufacturing process.
- "8. Manipulation.
- "9. Black lists, boycotts, white lists, etc.
- "10. Espionage and use of detectives.
- "11. Coercion, threats, and intimidation.

"The terms used fairly define without detailed discussion the various practices thus classified, and undoubtedly embrace nearly all of the methods of 'unfair competition' now in use. . . .

"Nearly all normal business men can distinguish between 'fair competition' and 'unfair competition.' Efficiency is generally regarded as the fundamental principle of power-efficiency in producing and in selling, while oppression or advantage obtained by deception or some questionable means is the distinguishing characteristic of 'unfair competition.'"

Senator Saulsbury defined it as

All "customs of merchants" which are in violation of "the ethics of a profession or a business."

According to Senator Walsh it included

Every act of passing off one's business or goods for another's.

All other acts comprehended within the meaning which "unfair competition" has to-day in common parlance and in literature.

Senator Williams' definition boiled down to

All unfair methods of stifling competition.

Senator Hollis' definition included

"Means of restraining or monopolizing trade" heretofore forbidden by the Sherman Law.

Methods which fall short of violating the Sherman Law but which "the proposed trade commission . . . decides . . . may lead to monopoly or restraint of trade."

All other acts which interfere with "efficiency."

From all these various definitions, offered by sponsors of the bill, unfair competition would seem to include

Every act of passing off one's business or goods for another's.

All methods of competition tending to restraint of trade or monopoly which have been forbidden by the Sherman Law.

Substantially all violations of the antitrust laws, including even wrongs arising from interlocking directorates and allied incorporate relationships.

All unfair methods of stifling competition.

All other acts which the "commission . . . decides . . . may lead to monopoly or restraint of trade" though not now forbidden by the Sherman Act.

All other acts affecting a competitor for which "a remedy lies either at law or in equity."

All other acts which either affect a competitor and are "against public morals," or in any way interfere with economic "efficiency," though heretofore quite lawful and not forbidden by the Sherman law or by any other law.

The provision regarding "unfair competition" was vigorously assailed on the floor of the Senate by Senators Thomas, Clapp, Pomerene, Sutherland, Borah, Nelson, Colt, Brandegee, Sterling, McCumber and Reed as either limited to "passing off" one's business or goods for another's, or as so hopelessly indefinite as to be absolutely meaningless. Sponsors of the bill cited, during the course of the debate, various decisions in which "unfair competition" or "unfair methods of competition" or "unfair" practices had been mentioned,¹ and various other decisions in which "fair competition" had been mentioned² and a decree in which "unfair competition" had been enjoined³ and a decree in which "fair competition" had been mentioned⁴ and various decrees in which neither "unfair" nor "fair" competition had been mentioned, but certain specified methods of competition had been particularly enjoined.⁵ But these vari-

¹ *Standard Oil Co. v. United States*, 221 U. S. 1, 43; 1911. *State v. Central Lumber Co.* 123 N. W. (S. D.) 504, 509, affirmed *Central Lumber Co. v. South Dakota*, 226 U. S. 158; 1913. *United States v. American Naval Stores Co.*, 172 Fed. 455, 459; 1909. *Ware-Kramer Tobacco Co. v. American Tobacco Co.*, 180 Fed. 160; 1910. *United States v. Patterson*, 205 Fed. 292, 301; 1913; reversed 222 Fed. 599; 1915. Beside these might be cited the cases of *United States v. American Tobacco Co.*, 221 U. S. 106, 179; 1911. *Buckeye Powder Co. v. E. I. du Pont de Nemours Powder Co.*, D. C. N. J. Feb. 25, 1914, Judge Rellstab's charge to the jury, not reported, affirmed in 223 Fed. 881; 1915. *United States v. Keystone Watch Case Co.*, 218 Fed. 502, 515; 1915.

² *In re Greene*, 52 Fed. 104; 1892. *Ware-Kramer Tobacco Co. v. American Tobacco Co.*, 180 Fed. 160; 1910. *State v. Fairmont Creamery Co.*, 153 Iowa 702, 709-710; 1912. Beside these might be cited the case of *Buckeye Powder Co. v. E. I. du Pont de Nemours Powder Co.*, *supra*.

³ *United States v. Central West Publishing Co.*, D. C. N. D. Ill., August 3, 1912.

⁴ *United States v. General Electric Co.*, N. D. Ohio, October 12, 1911.

⁵ *United States v. Aluminum Co. of America*, D. C. W. D. Pa., June 7, 1912. *United States v. American Coal Products Co.* D. C. S. D. N. Y., March 4, 1913. Beside these might be cited the decrees in *United States v. Noms Retail Grocers' Association*, D. C. Alaska; November 5, 1905. *United States v. National Association of Retail Druggists*, C. C. Ind., May 9, 1907. *United States v. Southern*

ous decisions and decrees, all of which were rendered either under the Sherman Act or under one or another of the various state statutes against price discrimination, indicated to the minds of these opposing Senators no clear definition of "unfair competition." They merely convinced them of the importance of adhering strictly to the specific, well-defined language of the Sherman Act and the various state statutes against price discrimination. Restraint of trade had long been a definite term in the law, and price discrimination was easily defined. "Unfair competition," in their opinion, had acquired no such definiteness.

Nevertheless the Trade Commission bill, with this provision declaring "unfair methods of competition" unlawful, passed the Senate by vote of 53 to 16.

In conference, the words "unfair methods of competition" were substituted for the words "unfair competition," for the purpose, apparently, of preventing the clause from being limited to cases of "passing off" one's business or goods for another's.

The enforcement of this section, and of the sections of the Clayton Act relating to price discriminations, exclusive contracts, intercorporate stockholding (except where applicable to carriers, when the Interstate Commerce Commission takes jurisdiction) and interlocking directorships (except where ap-

Wholesale Grocers' Association, C. C. N. D. Alabama, October 17, 1911. *United States v. Standard Sanitary Manufacturing Co.*, C. C. Md., November 25, 1911. *United States v. Standard Wood Co.*, C. C. S. D. N. Y., March 11, 1912. *United States v. Pacific Coast Plumbing Supply Association*, C. C. S. D. Cal., January 6, 1912. *United States v. Philadelphia Jobbing Confectioners' Association*, E. D. Pa., February 17, 1913. *United States v. Burroughs Adding Machine Co.*, D. C. Mich., March 3, 1913. *United States v. New Departure Manufacturing Co.*, D. C. W. D. N. Y., May 27, 1913. *United States v. Elgin Board of Trade*, D. C. N. D., Ill., April 27, 1914. *United States v. National Wholesale Jewellers' Association*, D. C. S. D. N. Y., June 30, 1914. *United States v. Eastern States Lumber Dealers Association*, C. C. S. D. N. Y., March 1, 1913, affirmed 234 U. S. 600; 1914. *United States v. Hamburg-Amerikanische Packetfahrt Actien-Gesellschaft, and others*, D. C. S. D. N. Y., October 13, 1914, 216 Fed. 971; 1914, but reversed because now moot in consequence of the European War, 239 U. S. 1; 1915.

plicable to banks and carriers, when the Federal Reserve Board and the Interstate Commerce Commission respectively take jurisdiction) is vested in the Federal Trade Commission. The jurisdiction of the Commission in respect of "unfair methods of competition" is exclusive; but in respect of the sections of the Clayton Act above mentioned, it is concurrent with proceedings by the Attorney General and by private complainants in the federal courts.

The procedure of the Commission in respect of "unfair methods of competition" is elaborately defined in section 5 of the Federal Trade Commission Act. Briefly, it consists of the following steps:

(1) If "the Commission shall have reason to believe that any . . . person, partnership, or corporation has been or is using any unfair method of competition," and "if it shall appear to the Commission that a proceeding by it in respect thereof would be to the interest of the public," it serves a complaint upon the defendant, giving 30 days notice of hearing.

(2) The hearing before the Commission then occurs; anyone "upon good cause shown" may intervene; the defendant may show cause why an order should not be entered against him; testimony shall be reduced to writing and filed with the Commission.

(3) If the Commission is of the opinion that the method of competition in question is prohibited by the Act, the Commission shall report in writing its findings of fact and shall issue its order against the defendant. If the Commission is of the opinion that the statute is not being violated, the Commission apparently is not required to report in writing its findings of facts or to make any order in the premises.

(4) If the Commission deems proper, it may at any time before the transcript of record is filed in the Circuit Court of Appeals, as provided in (5) below, modify or set aside in whole or in part such report or order.

(5) If the defendant fails to obey the order against him, the

Commission may upon filing the transcript of the record (including the testimony, report and order) apply to the Circuit Court of Appeals, where the defendant resides or carries on business or violated the statute, for a decree enforcing its order; the jurisdiction of the Circuit Court of Appeals is exclusive, and such proceedings shall be given precedence over other cases; the court shall serve upon the defendant notice of the filing of such application and transcript.

(6) If the defendant desires a review of the order against him he may, upon filing in the Circuit Court of Appeals a petition praying that the order be set aside, obtain a review; the jurisdiction of the Circuit Court of Appeals is exclusive, and such proceedings shall be given precedence over other cases; a copy of the petition shall be served on the Commission which shall certify the filing of the transcript. It seems that if the Commission should decide in favor of the defendant, and report in writing its findings of fact, and issue its order to the effect that the statute was not being violated, there would be no method for reviewing such report and order.

(7) The Circuit Court of Appeals shall take jurisdiction of the proceedings and of the questions determined therein; the jurisdiction of the Circuit Court of Appeals shall be exclusive, and such proceedings shall be given precedence over other cases; the evidence of the Commission as to the facts, if supported by testimony, shall be conclusive.

(8) If either party applies in the Circuit Court of Appeals for leave to adduce additional evidence, and shall satisfy the court that it is material and that there were reasonable grounds for failure to adduce it before the Commission, the court may order it to be taken before the Commission; and the Commission may modify its findings as to the facts, and may make new findings by reason of additional evidence so taken, and shall return such additional evidence and file such modified or new findings, and recommend modifying or setting aside its original order; the court may order such additional evidence

to be adduced upon the hearing before the court in such manner and on such terms as the court deems proper.

(9) The Circuit Court of Appeals shall have power to make and enter upon the pleadings, testimony and proceedings set forth in such transcript a decree affirming, modifying or setting aside the order of the Commission.

(10) The decree of the Circuit Court of Appeals shall be final, excepting that it may be reversed by the Supreme Court upon certiorari and that it shall not in any wise relieve or absolve any person from any liability under the antitrust acts. No order of the Commission or board or the judgment of the court to enforce the same shall in any wise relieve or absolve any person from any liability under the antitrust acts.

The first proceeding by the Commission under the act is now pending in the first stage above described.

The procedure of the Commission, in respect of violations of the Clayton Act, is substantially the same as that regarding "unfair methods of competition"; excepting that the requirement, in the first stage of the latter procedure, that "it shall appear to the Commission that a proceeding by it in respect thereof would be to the interest of the public" is significantly omitted.

Since "unfair methods of competition" have not yet been defined by the courts, and since the Senate has proved so hopelessly divided upon the definition, it is hardly the part of prudence to venture at this time any definition whatsoever. For the purpose, however, of correcting what is believed to be a serious misconception, likely to be fostered by the first proceeding already begun by the Commission, the following observations are summarily stated:

"Unfair methods of competition" are those methods of competition that already are forbidden by the Sherman Act. They are the methods of business competition denounced in a long line of Supreme Court and federal court decisions, and in

a number of decrees in Government suits under the Sherman Act.¹ In this connection, it is fair to add that these precedents show many more methods of business competition to be forbidden by the Sherman Act than were generally supposed, in Congress or outside, when the Federal Trade Commission Act was passed.

"Passing off" one's goods or business for another's, misbranding, and similar acts which, in Justice Holmes' phrase in *Nash v. United States*² are "no more than . . . small dishonesties of trade" and "small local offenses" that cannot be said to "prejudice the public interests by unduly restricting competi-

¹ See *Standard Oil Co. v. United States*, 221 U. S. 43; 1911. *United States v. American Tobacco Co.*, 221 U. S. 106, 179; 1911. *Central Lumber Co. v. South Dakota*, 226 U. S. 157; 1913. *United States v. American Nasal Stores Co.*, 172 Fed. 455, 459; 1909. *Ware-Kramer Tobacco Co. v. American Tobacco Co.*, 180 Fed. 160; 1901. *United States v. Keystone Watch Case Company*, 218 Fed. 502, 515; 1915. *Buckeye Powder Company v. E. I. du Pont de Nemours Powder Co.*, D. C. N. J., February 25, 1914, Judge Rollstab's charge of the jury, not reported, affirmed in 223 Fed. 881; 1915. See also the decree in *United States v. Central West Publishing Company*, D. C. N. D. Ill., August 3, 1912, in which "unfair competition" was enjoined, and the decree in *United States v. General Electric Co.*, N. D. Ohio, October 12, 1911, in which "fair competition" was mentioned, and the decrees in the following cases in which neither "unfair" nor "fair" competition was mentioned, but certain specified methods of competition were particularly enjoined; *United States v. Aluminum Co. of America*, D. C. W. D. Pa., June 7, 1912. *United States v. American Coal Products Co.*, D. S. S. D. N. Y., March 4, 1913. Besides these might be cited the decrees in *United States v. Nome Retail Grocers' Association*, D. C. Alaska, November 5, 1905. *United States v. National Association of Retail Druggists*, C. C. Ind., May 9, 1907. *United States v. Southern Wholesale Grocers' Association*, C. C. N. D. Alabama, October 17, 1911. *United States v. Standard Sanitary Manufacturing Co.*, C. C. Md., November 25, 1911. *United States v. Standard Wood Co.*, C. C. S. D. N. Y., March 11, 1912. *United States v. Pacific Coast Plumbing Supply Association*, C. C. S. D. Cal., January 6, 1912. *United States v. Philadelphia Jobbing Confectioners' Association*, E. D. Pa., February 17, 1913. *United States v. Burroughs Adding Machine Co.*, D. C. Mich., March 3, 1913. *United States v. New Departure Manufacturing Co.*, D. C. W. D. N. Y., May 27, 1913. *United States v. Elgin Board of Trade*, D. C. N. D. Ill., April 27, 1914. *United States v. National Wholesale Jewellers Association*, D. C. S. D. N. Y., June 30, 1914. *United States v. Eastern States Lumber Dealers Association*, C. C. S. D. N. Y., March 1, 1913, affirmed 234 U. S. 600; 1914. *United States v. Hamburg-Amerikanische Packetfahrt Actien-Gesellschaft*, and others, D. C. S. D. N. Y., October 13, 1914, 216 Fed. 971, 1915, but reversed because now moot in consequence of the European War, 239 U. S. 466; 1914.

² 229 U. S. 373, 376, 378; 1913.

tion or unduly obstructing the course of trade¹" are not, it is submitted, "unfair methods of competition" punishable under the Federal Trade Commission Act. Support for this view is supplied by the subsequent provision in the same section, which requires that "it shall appear to the Commission that a proceeding by it in respect thereof would be to the interest of the public." This seems, indeed, to incorporate the very test that Judge Holmes expressed in the passage above quoted.

Support for this view is also found in the essential character of the Commission. It is not, and cannot be, a judicial body. Since the Commission must always be the complainant in all proceedings before it, and the Federal Trade Commission Act, unlike the Interstate Commerce Commission Act, provides for no such party as a private complainant, the Federal Trade Commission seems lacking in at least one quasi-judicial function possessed by the Interstate Commerce Commission. The Federal Trade Commission is an administrative body, charged with public duties, with only such quasi-judicial functions as the Act confers for the more perfect administration of its public duties.

These considerations, independent of the unlikelihood that Congress had any intention of paralleling the federal and state courts with another tribunal for the adjustment of personal controversies, or of smothering under this avalanche of private trade disputes a Commission charged with so many well-defined and highly important duties, seem clearly to support the interpretation above suggested.

The reports which the Commission has published, the conference rulings it has announced, and the proceedings it has commenced, are only a fraction of the work it has already accomplished.

Hundreds of petitions for the issuance of complaints have been and are being handled by the Commission. Under a

¹ Citing *Standard Oil Company v. United States*, 221 U. S. 1, 42; 1911. *United States v. American Tobacco Company*, 221 U. S. 106, 179; 1911.

policy of notifying the party complained of before any proceedings under the Act are begun or even determined upon by the Commission, and of affording the party complained of opportunity to explain matters before these steps are taken, scores of matters have been and are being adjusted without the necessity of any formal proceedings.

By an arrangement with the Attorney General, complaints lodged with the Department of Justice, regarding matters already under investigation by the Commission, are now being turned over to the Commission for action.

Whether the Commission will, or legally can, undertake to consider the legality of business projects submitted to it in advance of their consummation, is not and probably will not be settled for some time to come. Several conference rulings, that the Commission already has made, seem to point in this direction. The legal and practical arguments against such practice, however, are very formidable. No authority to enforce or even interpret the Sherman Act appears to be vested in the Commission. Without this jurisdiction, the Commission is, and will be, helpless to rule, either before or after the event, upon questions of organization and combination, arising under the Sherman Act.

Nevertheless, a great area, once under the Sherman Act, and now included under the "unfair methods of competition" section of the Federal Trade Commission Act, and the "price discrimination" and "exclusive contract" section of the Clayton Act, has come under the jurisdiction of the Commission. To this has also been added the unexplored field defined by the "intercorporate stockholding" and "interlocking directorship" sections of the Clayton Act.

Wise exercise of the Commission's powers and sound choice of its policy ought eventually to lead to its being permitted to take over from the Attorney General a troublesome variety of antitrust cases that now threaten to swamp the Department of Justice; and, even more auspiciously, to the Commission's

making to Congress recommendations ripened by full study and a wealth of experience for the correction of legislative mistakes and omissions regarding our domestic, and more particularly our foreign commerce, by which governmental practice and commercial efficiency may at last be brought into a degree of harmony to which both have heretofore been unhappily strangers.

THE PUBLIC SERVICE COMMISSIONS

A Lecture Delivered before the Association of the Bar of the City of New York
by George S. Coleman, March 29, 1916

THE Committee on Lectures have suggested that I confine myself to a statement of the origin of the Public Service Commissions Law of New York, its general provisions, the organization of the Commissions and the method of work under the Law, with perhaps a reference to some decisions of the courts that have clarified the legislative intent.

The germ of this law may be found in the first inaugural address of Governor Hughes, January 1, 1907. His early statements are like the overture of an opera, in that the law as passed and now in effect carries out in detail the suggestions of the inaugural and earliest messages. The following paragraph from the inaugural is significant :

It must freely be recognized that many of the evils of which we complain have their source in the law itself, in privileges carelessly granted, in opportunities for private aggrandizement at the expense of the people recklessly created, in failure to safeguard our public interests by providing means for just regulation of those enterprises which depend upon the use of public franchises. Wherever the law gives unjust advantage, wherever it fails by suitable prohibition or regulation to protect the interests of the people, wherever the power derived from the State is turned against the State, there is not only room, but urgent necessity for the assertion of the authority of the State to enforce the common right.

In his first message to the Legislature, on January 2, the Governor referred to various matters of importance but gave the greatest prominence to the subject of Public Service Corporations. The following extracts will perhaps best indicate what he had in mind :

Proper means for the regulation of the operation of railroad corporations should be supplied. For want of it, pernicious favoritism has been practiced. Secret rebates have been allowed, and there have been unjust discriminations in rates and in furnishing facilities for transportation. Those who have sought to monopolize trade have thus been enabled to crush competition and to grow in wealth and power by crowding out their rivals who have been deprived of access to markets upon equal terms. These abuses are not to be tolerated. Congress has legislated upon the subject with reference to interstate commerce, where naturally the evil has been most prominent. But domestic commerce must be regulated by the State, and the State should exercise its power to secure impartial treatment to shippers and the maintenance of reasonable rates. There is also need of regulation and strict supervision to insure adequate service and due regard for the convenience and safety of the public. The most practicable way of attaining these ends is for the Legislature to confer proper power upon a subordinate administrative body.

The present scheme of regulation is inadequate. There is a lack of precision in the definition of the powers of the board and an absence of suitable means to compel compliance with its decisions. No penalties are provided for disobedience to orders of the board made within its proper authority. Nor is the board authorized to institute and conduct legal proceedings for the purpose of enforcing its requirements.

I, therefore, recommend that the present Board of Railroad Commissioners and the Commission of Gas and Electricity be abolished and that a new commission be constituted, with powers of regulation and supervision, within constitutional limits, of the corporations now subject to the existing commissions. The commission should have all the powers possessed by the present commissions and such additional powers as may be needed to insure proper management and operation. Its powers should be clearly defined and should embrace the power to act upon its own initiative as well as upon complaint; to pass upon the issue of stocks and bonds; to examine properties, books, and accounts; to require detailed reports in prescribed form; to prescribe reasonable rates; to require adequate and impartial service; to provide for the safety of employees and for the protection of the public; and generally to direct whatever may be necessary or proper to safeguard the public interests and to secure the fulfillment of the public obligations of the corporations under its supervision. Provision should be made for suitable inspection so that the commission may be advised as to all matters within its purview and be in a position

to take action on behalf of the people without the formal institution of proceedings by complainants. A prescribed quorum should be entitled to decide all questions, and any one commissioner should be empowered to make examinations and investigations, and the proceedings and decisions of one, when approved by the board, should stand as its proceedings and decisions.

The corporation guilty of disobedience to its orders, and all officers and other persons responsible for such disobedience should be visited with appropriate penalties. The commission should also be entitled to institute legal proceedings for the enforcement of its orders and all such proceedings should be expedited by suitable preference in all the courts of the State. The Legislature should thus provide, within its constitutional power, adequate means for the entirely just and impartial regulation of these important public enterprises.

After making special reference to conditions in Greater New York and clearly stating his reasons for thinking that there should be one commission for that city and a separate commission for the rest of the State, he closed the subject with this recommendation :

I recommend that the Board of Rapid Transit Commissioners be abolished and that a new board be created, to have all the powers now exercised by the Rapid Transit Board, and also to have powers with reference to operations within the territory of Greater New York, — or if deemed advisable, within a wider district embracing the adjoining counties into which certain lines of the surface railroads extend, — similar to the powers which I have suggested should be conferred upon the new commission for the rest of the State. There would thus be included the regulation of gas and electric corporations. Provision should be made for the retention by the board of estimate and apportionment of the city, of all the powers, including powers of approval, which it now enjoys. The commission proposed for the State generally should have jurisdiction over all traffic between points within the city of New York and points elsewhere in the State. It is believed that in this manner the whole question of transportation, and of gas and electric service, in the territory of Greater New York can be dealt with in an intelligent and efficient manner, and that to the fullest extent possible the just requirements of that great community may be satisfied.

The first emergency message of Governor Hughes to the Legislature in 1907 related to Senate Bill No. 1738, entitled "An Act to establish the public service commissions and prescribing their powers and duties, and to provide for the regulation and control of certain public service corporations and making an appropriation therefor."

Every Governor from Cleveland down had at one time or another suggested some form of control and regulation of public service corporations by state officials, but it remained for Governor Hughes to have the idea put in systematic form and made effective. As you read the Public Service Commissions Law of 1907 you find that every important suggestion of the first message is crystallized in the statute.

Instead of being purely advisory the work of the Commission is directory, and the law has sharp teeth. If the facts warrant, the parties who fail to obey either the law or the orders of the Commission may be suitably punished in civil or criminal proceedings. You will find provisions to overcome the defects of the railroad law of years ago, when favoritism was disclosed, when different rates were allotted to the same classes of shippers, when rebates were permitted to some and denied to others — abuses that gave rise to the Granger Cases and led ultimately, as you know, to the Interstate Commerce Law. But even the Interstate Commerce Law did not contain the provisions of the Public Service Commissions Law which give power to the Commissions, through the properly constituted authorities, to enforce their lawful orders.

General Provisions

It is hardly necessary, nor does it seem desirable, on this occasion to discuss in detail the provisions of the Public Service Commissions Law. Those who have occasion to refer to it will find the provisions embodied in a single statute, with amendments, and they will discover that although relating to

different classes of corporations somewhat similar provisions are found with respect to each particular kind of service.

The Law was originally enacted in 1907. It applied to railroads, street railroads and common carriers, gas and electric corporations. By the general revision of 1910 a new article was added relating to telegraph and telephone corporations and in 1913 a further article was enacted relating to steam corporations. By the original act of 1907 the former board of railroad commissioners, the commission of gas and electricity and the board of rapid transit railroad commissioners were abolished and the powers and duties of such boards were conferred and imposed upon the Public Service Commission. Also, the offices of inspector and deputy inspectors of gas meters were abolished and their powers and duties likewise transferred.

As in most modern legislation of this character, the statute begins with definitions of the various important words and phrases used in the Law. In Article I the territorial limits of the two districts are stated, the jurisdiction of the respective Commissions is defined, provisions are made for necessary officers, clerks, inspectors, experts and employees, for meetings of the Commissions, payment of salaries and expenses, reports of Commissions, attendance of witnesses and practice before the Commissions, court proceedings, service and effect of orders and actions to recover penalties or forfeitures.

In Article II are found provisions relating to railroads, street railroads and common carriers, their service and charges, switch and side-track connections, publication of tariff schedules, contracts, agreements or arrangements between carriers, unjust discrimination, unreasonable preference, transportation, rates and passes, false billing by carrier or shipper and similar provisions.

Article III contains provisions relating to the powers of the Commissions in respect to common carriers, railroads and street railroads; the duty of such corporations to make and file periodical reports; investigation of accidents; the fixing of

rates and service; power of Commissions to order necessary repairs or changes in tracks, switches, terminals, etc., and the power of the Commissions to order changes in schedules for the running of cars and trains; establishment of uniform system of accounts and the right of access to accounts; necessity of securing permission and approval for exercising of franchises and privileges, for transfer of franchises or stocks, for the issue of stocks, bonds and other forms of indebtedness; supervision and authorization of reorganizations; and forfeitures or penalties for violations of the Law or failure to comply with orders of the Commission.

Article IV contains appropriate provisions with respect to gas and electrical corporations and the regulation of the price and quality of gas and electricity; and the later Articles of 1910 and 1913 contain appropriate provisions to carry out the same general purpose for the control of telephone and telegraph corporations and steam corporations.

In connection with the provisions of the Public Service Commissions Law must be considered the provisions of the Railroad Law, the Transportation Corporations Law and the Stock Corporation Law.

Speaking generally and considering the Law as a whole, the declared object of the Legislature was to secure, in every instance, *safe and adequate service, just and reasonable rates, SAFE AND ADEQUATE SERVICE, JUST AND REASONABLE RATES*; and the whole endeavor, apparently, of the State is to harmonize those two things. But often it is difficult to apply the principle satisfactorily and to determine in a given case what is safe and adequate service and what are just and reasonable charges. Perhaps no two cases are exactly alike and there is room for the ingenuity of man to present obstacles as serious and as hard to get over as the pitfalls and barbed wire entanglements of modern defensive warfare. If any difficulty encountered is due to a defect in the statute, the remedy of the people through the Commission is to secure an amendment of

the statute. If there is a fundamental defect in the Law, it may require even a constitutional amendment. In a proper case it is believed that the people of the State will not hesitate to grant the necessary powers to carry out the legitimate objects of their legislation.

It may be noted that while the work of the Commissions is divided generally by territorial lines (the Commission for the First District attending to matters in the counties constituting Greater New York and the Commission for the Second District attending to matters in the rest of the State), the regulation of telegraph and telephone corporations is committed exclusively to the Commission for the Second District, while the powers and duties arising under the Rapid Transit Act are exercised and performed exclusively by the Commission for the First District. And in cases where it appears to both Commissions that separate jurisdiction has not been conferred "a joint hearing shall be fixed and had by members of both commissions, and the determination shall be by joint order, which shall be effective when concurred in by not less than three members of each commission." (§ 49, 5.)

The Rapid Transit Act (Laws of 1891, Chapter 4), "AN ACT to provide for rapid transit railways in cities of over one million inhabitants," as amended to date, while in form a general statute, affects now only the City of New York. It is designed to secure for the people of the City the necessary extension and improvement of intra-urban railroad service at a low and uniform fare. It is the province of the Commission to determine the necessity for new routes or lines and to initiate the necessary proceedings, prepare plans, contracts and specifications for construction, equipment and operation and to supervise generally and in detail the work of such construction. In a work of such magnitude, involving under present plans an investment by the City and by private railroad corporations of over three hundred million dollars, it is essential that while the initiative under the law belongs to the Commission the

approval of the local authorities should be secured before a new route or line is established or public money committed to the enterprise. Under constitutional provisions it also is necessary to secure the consents of abutting property owners, or in lieu thereof the consent of the courts, before a new route can be legalized.

It may be remembered that when the Public Service Commissions Law was proposed it did not have the approval of the local authorities of the City of New York. It also may be remembered that after its enactment the validity of the Law was assailed in the courts, and that it was not found convenient to secure money for rapid transit development because a question had been raised as to the City's borrowing capacity under the provisions of the State Constitution. It took years to have these matters judicially determined; and while the demand for increased transit facilities became urgent and insistent there was not money enough to enable the City to carry out its part of the program until not only additional legislation had been secured but also an amendment to § 10 of Article VIII of the Constitution providing that certain rapid transit bonds might be excluded in estimating the City's indebtedness. When these adverse conditions were finally overcome, one great object of the Commission was achieved by the ratification in March, 1913, of what are commonly known as the Dual System Contracts for the construction and operation of the entire rapid transit system of Greater New York. The work is proceeding rapidly toward completion. When entirely completed the effect will be to treble and in some places to quintuple existing service. In spite of all that may be said as to the wisdom or unwisdom of the contracts, if at the end of the period provided for in the operating agreements the City takes over, without further obligation, the roads into which so many millions of dollars of private capital have gone, it will not have spent its money in vain. Of course, when the contracts were made, it was anticipated that in the course of time the City would

receive not only what it contributed but interest on the investment and a share of the profits. But in any event the completion of the stupendous undertaking will have added enormously to the values of real estate and will greatly enhance the comfort and convenience of our teeming population.

Organization of Commission

To carry out the purpose of the Law the Public Service Commission for the First District has been obliged to organize and maintain a large and diversified staff. The duties imposed by statute upon the five commissioners appointed by the Governor would, of course, be impossible of performance without the aid of numerous and efficient assistants and employees. Section 8 of the Law provides :

Each commission shall have power to employ, during its pleasure, such officers, clerks, inspectors, experts and employees as it may deem necessary to carry out the provisions of this chapter, or to perform the duties and exercise the powers conferred by law upon the commission.

Under this authority the organization of the Commission for the First District has grown to include

1. Commissioners and staff.
2. General administration.
3. Legal Department.
4. Bureau of Transit Inspection.
5. Bureau of Gas and Electricity.
6. Bureau of Statistics and Accounts.
7. Bureau of Electrical Equipment and Inspection.
8. Engineering Department.

On January 1, 1915, the number of Commissioners and members of the various staffs amounted to 2107, and the payroll aggregated \$2,909,873. The salaries of the Commissioners, Counsel and Secretary — aggregating \$91,000 — were payable by the State; the balance by the City of New York. At the

present time I am informed that the number now embraced in the organization is about 2,300, mainly due to increased work of the Engineering Department on account of rapid transit construction. As that progresses to completion the various staffs will doubtless rapidly decrease in numbers until perhaps three hundred persons will be able to handle the regular work of the Commission. If even that number should seem excessive, a careful reading of the provisions of the Law relating to the powers and duties of the Commissions in relation to common carriers, railroads, gas and electric corporations and steam corporations would probably satisfy you that the estimate was moderate. Take for example the following from § 45, subdivision 2:

Each commission shall have the general supervision of all common carriers, railroads, street railroads, railroad corporations and street railroad corporations within its jurisdiction as hereinbefore defined, and shall have power to and shall examine the same and keep informed as to their general condition, their capitalization, their franchises and the manner in which their lines and property, owned, leased, controlled or operated, are managed, conducted and operated, not only with respect to the adequacy, security and accommodation afforded by their service, but also with respect to their compliance with all provisions of law, orders of the commission and charter requirements. Each commission shall have power, either through its members or responsible engineers or inspectors duly authorized by it, to enter in or upon and to inspect the property, equipment, buildings, plants, factories, power-houses and offices of any of such corporations or persons. . . .

Consider, also, the work involved in connection with the annual and other reports of corporations under § 46; with investigation of accidents under § 47; with investigations of complaints under § 48; with rates and service under §§ 49, 50 and 51; with corporate accounts under § 52, franchises and privileges under § 53, transfer of franchises and stocks under § 54, approval of issues of stock, bonds and other forms of indebtedness under § 55, with reorganizations under § 55a,

and with forfeitures and penalties and summary proceedings under §§ 56-58. Then consider similar work arising with respect to gas and electric corporations and steam corporations. Consider, also, the number of the various corporations under the jurisdiction of the Commission, their capitalization, the extent and complexity of their business, and the multitude of people daily and hourly affected by their operation. The responsibility for the proper supervision and regulation of these corporations in affairs so vast and so important to the welfare, comfort and convenience of the people and to the interests of the corporations themselves, demands at all times a sufficient and capable staff.

Method of Work

All matters for the Commission go first to the administration department and are there duly assigned. If a complaint is sent to the legal department for attention, it is usually taken up with the department or bureau having general charge of the subject-matter. If a public hearing is deemed necessary, the matter is put upon the calendar and set down for a day certain and the parties are notified. There are, of course, thousands of complaints that never reach the form of an order, or even of a public hearing, but are disposed of by correspondence or by informal conference. Many hundreds of hearings, however, have been formally held and have resulted in formal orders. Some cases have taken an hour, some half a day, some have consumed weeks or months or even years, before the hearings were concluded and the matter disposed of. *Rate* cases are particularly liable to be protracted. They usually involve the investigation of ancient and voluminous records and technical evidence by experts. Since the rate looks to the future, if it is urged that the prices of labor and materials are advancing and that they will continue to advance, the facts must be carefully established and considered. While there have been complaints of delay incident to rate cases, it has seemed impossible

at times to expedite such cases and yet give a full and fair hearing to the parties concerned. However, speed may come with experience. If some bright legal mind would devise a system of legal logarithms, some simple formula whereby, with certain known elements in any given case, you could immediately indicate the just and reasonable rate, a great boon would be conferred upon every modern community. Meantime, an amendment of the Law providing for *rebate* covering the period of controversy in case of eventual reduction would encourage a prompt determination of the issue.

Where the question presented involves a proposed issue of stock or bonds, it usually requires the attention of the accountants. Where it is a question of refunding outstanding obligations, it may be quite impossible, owing to lost or defective records, to prove that the obligations were originally issued for a *capital* as distinguished from an *operating* purpose; and yet the fact should somehow be established. Also it may be disclosed that the property purchased with the proceeds of securities concededly issued for a capital purpose has become worn out or destroyed and that no replacements have been made nor any depreciation fund maintained. If in such case it should be held that because obligations were originally issued for a capital purpose the Commission must allow new obligations to replace them, without existing property to represent them, it might seriously interfere with the apparent intent of the legislature as indicated in § 55 of the Public Service Commissions Law relating to railroads, street railroads and common carriers, and in similar provisions relating to other corporations under the jurisdiction of the Commissions.

Matters affecting travel on surface or other railroads, complaints as to transfers, overcrowding, shortage of cars, lack of facilities and other matters affecting the comfort and convenience of the public are handled by the Bureau of Transit Inspection. Questions as to the quality of gas or electricity, including the accuracy of meters, are referred to the Bureau of Gas and

Electricity; and where the safety or adequacy of electrical equipment is involved, to the Bureau organized for that purpose. The Engineering Department, as its name suggests, is concerned with matters of construction, equipment and supervision of railroads, power houses, tunnels, bridges, sewers, and other structures connected with the operation of companies subject to the jurisdiction of the Commission. Its principal work during the years since 1907 has been in connection with the plans and construction contracts for the development of rapid transit, and it also has supervised the important work of eliminating dangerous grade crossings under the Railroad Law.

The work accomplished by the Commissions in both districts is set forth in annual reports, in records of proceedings and in volumes of opinions, in printed and permanent form, accessible to public inspection. The variety and practical importance of matters arising from day to day would interest any intelligent citizen and would appeal particularly to lawyers. More than seven hundred written opinions have been rendered by the legal department to the Commission for the First District, and a much larger number of oral opinions.

About fifty litigated cases have been tried and determined, not including cases arising under the Rapid Transit Act. A brief reference to several of the reported decisions may help to illustrate the character of the questions involved.

The case of *People ex rel. Joline v. Willcox*,¹ arose in connection with the attempt of our Commission to establish transfers on certain street surface lines in the City of New York. The Supreme Court of the United States had held that fixing a rate for the future was a *legislative* function (*Prentiss v. Atlantic Coast Line*²), but the Court of Appeals, with great reluctance, felt constrained to follow the views formerly expressed by the courts of this State, and to regard the fixing of a rate as at least *quasi-judicial* and subject to review by certiorari.

¹ 129 App. Div. (N. Y.) 267; 1908; 194 N. Y. 383; 1909.

² 211 U. S. 210; 1908.

In *Gubner v. McClellan*,¹ it was contended that the Public Service Commissions Law was obnoxious to Section 16 of Article 3 of the State Constitution, as being a private and local bill embracing more than one subject, and that it violated Section 10 of Article 8 in that it provided for incurring city debts for other than city purposes. Both contentions were overruled. Numerous other objections to the validity of the law were alleged in the complaint, but were not argued by counsel nor passed upon by the court.

*People ex rel. South Shore Traction Company v. Willcox*², involved the question whether, after the Commission had given its approval to a certain route proposed by a surface railroad company, and the company had obtained from the Board of Estimate and Apportionment what is called its local or secondary franchise, the Commission could thereafter decline to approve the construction of the road on the ground that it was not satisfied with the terms which the City imposed. The ordinary procedure for a company desiring to establish a new line is to apply to the Commission for a certificate of convenience and necessity, and then to the Board of Estimate for the constitutional consent of the local authorities, which takes the form of a franchise contract and contains many specific terms. Then the Commission is called upon under Section 53 of the Law to authorize construction and the exercise of franchise rights. In the case of the South Shore Traction Company the Commission had found that the route proposed was ideal, in fact the only available route from Jamaica to Manhattan Island, but when the matter came back from the Board of Estimate and the franchise contract contained certain provisions which the Commissioners did not approve they declined to give their consent under Section 53. The courts decided that the Commission could not withhold consent on the grounds stated. The Court of Appeals, however, did say that if any condition

¹ 130 App. Div. (N. Y.) 716; 1909.

² 133 App. Div. (N. Y.) 556; 1909; 196 N. Y. 212; 1909.

imposed by the local authorities should conflict with provisions of the Public Service Commissions Law the latter law should govern. In the case of the *City of Troy v. United Traction Company*,¹ it appeared that the City, by ordinance, tried to establish a ten-minute headway of cars on certain streets, but the Commission for the Second District had previously fixed a fifteen-minute headway as reasonable. The court held that the Public Service Commission had fixed the reasonable headway, after a hearing, at fifteen minutes, and that even though the City had made the ordinance originally it could not reduce the headway. The only way to secure relief, provided that relief was proper, would be to apply to the Commission itself for rehearing and, if necessary, have the matter reviewed in court. In other words, the Public Service Commissions Law is regarded as supreme, even as against the City, in matters that come within the regulatory powers of a Commission.

The case of *People ex rel. New York, New Haven & Hartford Railroad Company v. Willcox*,² involved the question of handling certain species of freight. We know it as the "Manure Case," because the handling of that refuse caused unpleasant odors in the region of the Harlem River, and many complaints were made to the Commission by persons living in the vicinity. It seemed to come within the general provisions of the Public Service Commissions Law, and the Commission, after a hearing, issued an order to the Company to take proper sanitary precautions in loading the cars, so that no offensive odors should arise. When the matter finally reached the courts it was decided by the Appellate Division, four to one, that the Commission had a right to direct what improvements should be made in the handling of that property, but in the Court of Appeals it was held, four to three, the other way. The decision turned on the point that in the particular case presented it was a matter of public health rather than of transportation, and

¹ 134 App. Div. (N. Y.) 756; 1909.

² 138 App. Div. (N. Y.) 330; 1910; 200 N. Y. 423; 1911.

that the care of the public health had been committed by the charter so exclusively to the City that it would take something very much stronger than the general language of the Public Service Commissions Law to deprive the City of jurisdiction. In the course of the prevailing opinion Judge Gray, referring to the Public Service Commissions Law, said (p. 431):

The object of the legislature, as fairly to be deduced from its enactment, was to regulate the management and the operations of common carriers, within the state, in the interest of the public; that is, of the persons who should use the facilities for the transportation of themselves, or of their property; who should serve them; or who should be interested in them, as holders of their capital stock, or obligations.

In other words, only the patrons, employees, shareholders or bondholders of a railroad constitute the "public" entitled to protection through the Commission. If, therefore, property owners along the line of a steam railroad should be annoyed by ashes, smoke or cinders from locomotives it might be necessary to call upon a board of health to abate the nuisance.

In *People ex rel. Delaware & Hudson Company v. Public Service Commission*¹ it was held that the Public Service Commission may reduce the rate of fare allowed by statute without infringing the constitutional prohibition against the impairment of contracts. It was decided that the act authorizing the Company to charge twenty-five cents a mile was not a contract, but a mere gift or concession and not a general right to change or alter or amend the charter.

In *Willcox v. Richmond Light and Railroad Company*,² the question was for the first time, I think, decided in this State that the ordinance of a village was in effect a statute. In the New Haven Railroad case, just referred to, Judge Gray, speaking of the duties of railroads and other corporations to comply with the "provisions of law," said (p. 432) that the words "provisions of law" did not mean "all the provisions of the statute, or common law," but obviously only the provisions of

¹ 140 App. Div. (N. Y.) 839; 1910.

² 142 App. Div. (N. Y.) 44; 1910; *aff'd* 202 N. Y. 515; 1911.

the Public Service Law; but I think even Judge Gray would have conceded, if the point had been pressed upon him, that the provisions of law, even when limited to the provisions of the Public Service Commissions Law, must, by implication, cover any provision of the Railroad Law or other statutes which the Commission is obliged to enforce. In the case of *Willcox v. Richmond Light & Railroad Company*¹ there were presented two village ordinances whereby two separate surface railroad companies were granted rights to operate within the village. In accepting the ordinances the companies agreed to exchange transfers with intersecting roads wherever their lines met within the village limits. Having refused to comply with the request for transfers, a mandamus proceeding was brought to compel them to do it. It was held by Mr. Justice Clarke, in Richmond, in an opinion which was adopted by the Appellate Division in Brooklyn, that where there is a violation of law, as the term is used in Section 57 of the Public Service Commissions Law, the Commission may compel the fulfillment of the obligation; and that the failure to comply with the requirement of an ordinance which had been duly accepted was as much a violation of law as would have been a violation of a statute.

There are, of course, many other decisions affecting different provisions of the Public Service Commissions Law. They are all interesting to those concerned. Perhaps reference may be permitted to the following:

Peo. ex rel. *Delaware and Hudson Co. v. Stevens*, 134 App. Div. 99; 1909. 197 N. Y. 1; 1909.

Peo. ex rel. *Cohoes Railway Co. v. Public Service Commission*, 143 App. Div. 769; 1911. 202 N. Y. 547; 1911.

Peo. ex rel. *Binghampton Light, Heat and Power Co. v. Stevens*, 143 App. Div. 789; 1911. 203 N. Y. 7; 1911.

Public Service Commission v. Westchester Street Railroad Co., 151 App. Div. 914; 1912. 206 N. Y. 209; 1912.

Peo. ex rel. *New York Edison Co. v. Willcox*, 151 App. Div. 832; 1912. 207 N. Y. 86; 1912.

¹ *Supra*.

Public Service Commission v. New York Railways Co., 77 Misc. 487; 1912.

Peo. ex rel. *Bridge Operating Co. v. Public Service Commission*, 153 App. Div. 129; 1912.

Peo. ex rel. *Kings County Lighting Co. v. Willcox*, 156 App. Div. 603. 157 App. Div. 922; 1913. 210 N. Y. 479; 1914.

Matter of Public Service Commission (Re Mendel), 162 App. Div. 371; 1914. 214 N. Y. 46; 1915.

Peo. ex rel. *Dry Dock, &c. Railroad Co. v. Public Service Commission*, 167 App. Div. 286; 1915.

Public Service Commission v. New York and Queens County Railway Co., 170 App. Div. 580; 1915.

In concluding this portion of the address I would refer to a single further case, *People ex rel. Ulster & Delaware Railroad Company v. Public Service Commission*, reported in the New York Law Journal of January 31, 1916.

The case involved a construction of Section 60 of the Railroad Law and Sections 33 and 49 of the Public Service Commissions Law. The question flatly presented was whether when a statute prescribed a rate of fare to be charged as a *maximum* the Commission, under its regulatory powers, might authorize an increase of rate above the statutory limit, if in its judgment the increase was necessary in order to provide a fair return for service rendered. The Commission had decided that it had no power to grant the increase. The Appellate Division of the Second Department divided three to two, Mr. Justice Cochrane writing the prevailing opinion, in which Justices Lyon and Howard concurred, declared the authority of the Commission to increase mileage book rates above two cents per mile, the maximum fixed by the Railroad Law. Justices Kellogg and Woodward dissented in elaborate opinions. The case will certainly be taken to the Court of Appeals, but has not yet been argued there.¹

¹ The opinions of the Appellate Division appear in 171 App. Div. 607. Upon appeal to the Court of Appeals, upon a question certified, the order of the Appellate Division was affirmed "on the opinion of Cochrane, J., below." The Court of Appeals divided four to three, 218 N. Y., memoranda.

There was no express provision in the Public Service Commissions Law for court review of the Commission's determinations. It was urged at the time that there should be some such provision, but none has ever been inserted. However, it is found that in most cases the decisions of the Commission, taking the form of orders, may be reviewed by *certiorari* under the provisions of the Code of Civil Procedure; in that way every judicial question may be presented and disposed of. And if the proceeding appears to have been taken in good faith, even though unsuccessful, the pendency of the litigation prevents the enforcement of penalties that otherwise might have been imposed under Section 24 of the Law.

Personally I believe in the right of judicial review, even though it cause some delay in the carrying out of orders. Where the matter reviewed involves technical knowledge, or a full and careful consideration of facts, if the record is sufficiently clear I think the tendency of courts will be less and less to interfere with the decisions of a properly constituted board. The burden put upon the relator under the Code provisions for review by *certiorari* is such that only a very strong case should prevail against the determination of the Commission.

When the Law became operative, on July 1, 1907, the City of New York was suffering from severe financial depression. Before the end of that year, or very shortly thereafter, nearly every surface railroad line in Manhattan was in the hands of a receiver. It was a very unpropitious time to begin administering a law which contained so many teeth and which imposed upon the Commissioners so many duties involving apparently endless investigation and the solution of long-standing problems. In the beginning there was much opposition to their action on the part of corporations and much dissatisfaction on the part of the general public. But many of the questions that eight years ago vexed both the public and the corporations have since been laid to rest. Commissioners have come and Commissioners have gone. But the law itself has been grad-

ually clarified either by amendment or by actual decisions of the courts, and as it stands to-day is pretty nearly, I think, as the Commission and the public generally would have it.

At the present time I believe every state in the Union (except Delaware and Utah) has established a commission of its own, and the District of Columbia has one. In compliance with the further suggestion of the Committee on Lectures I shall refrain from discussing the philosophy or psychology of Public Service Commissions as a whole, and shall leave that broader field to my brother Guthrie for consideration at the next meeting. But with respect to the particular Commission with which I have been intimately associated for eight years past, after an experience of twice that length of time in the City's Law Department, it is my privilege and pleasure to state that I have never seen a better *esprit de corps* among so many men and have never seen a larger volume of novel, difficult and important work better performed than by the members of the staffs of the various departments of the Public Service Commission. It is impossible always to satisfy the public or the corporations in the attempt to carry out the evident purpose of the Law; but I believe, gentlemen, that in the process of time, with the aid of the men themselves who represent the corporations, and with the aid and advice of the courts, and with the coöperation of the people, the conviction will be strengthened that Governor Hughes made no mistake in giving his prompt and vigorous attention to establishing a comprehensive system for the regulation and control of public utilities.

PUBLIC SERVICE COMMISSIONS

A Lecture Delivered before the Association of the Bar of the City of New York,
by William D. Guthrie, April 5, 1916.

IN his interesting and instructive address last Wednesday evening, Mr. George S. Coleman recalled to our minds the purposes of those who in 1907 promoted the governmental experiment involved in the creation of public service commissions vested with broad powers of regulation over businesses now generically called public utilities. Most of us, I assume, agree with him that the theory of regulation by commission is sound, that these commissions ought to be continued as permanent departments of government, and that they should be made effective and satisfactory instruments for the service of the public. I want to urge this evening, although in a manner necessarily cursory and incomplete, that public service commissions can be made permanently useful and successful only by observing three conditions, namely, (1) by limiting their powers to fewer and simpler functions, (2) by appointing as commissioners men who are really experts, qualified as such by technical training and practical experience, and (3) by eliminating all exercise of judicial power, or, if any judicial power be retained, then by affording the full judicial review necessary for the protection of the rights of those whose property and business are affected by such regulation.

It seems to me that you will regard it as quite fitting and proper for me to say that no one in the employ of our state or municipality in recent years has rendered more efficient or valuable public service or service of a higher standard of professional merit than Mr. Coleman has rendered as head of the law department of the Public Service Commission for the first dis-

trict.¹ He was exceptionally equipped to undertake the work after sixteen years of conspicuously able service in the office of the Corporation Counsel. Certainly to his advice, management and direction as counsel to the commission under many discouraging difficulties are due in great measure whatever success has attended its work so far and whatever promise its past labors and performances hold out for the future. I believe that this is generally recognized by the profession and that it awards to him the credit he deserves.

Of the political phenomena of our times, perhaps none is more striking than the constant extension of the functions of government, with the consequent multiplication of public officials and increase of public expenditures. The tendency to extend the activities of the state has been world-wide, for manifestations of it are observable in every country, whatever the form of government may be. In the United States we are developing at enormous cost in the most intensive fashion a multitudinous bureaucracy with autocratic powers and arbitrary discretion and a vast system of complicated and often conflicting administrative jurisdictions in business matters which reach and affect almost every individual, and most of which, only a few years ago, would have been regarded as of strictly private concern. We are vesting and combining in administrative bodies extensive legislative, administrative and judicial powers in distinct and reckless disregard of the sound principle of the separation of governmental powers which was deemed so essential by the wise founders of our governments. Even controverted questions of law and fact heretofore regarded as exclusively for judicial determination we are entrusting to bureaucratic discretion, and for orderly judicial procedure and the competent and impartial interpretation and enforcement of the laws, we are substituting arbitrary methods and untrained judgment. The increase in public functionaries and public expenditures within the past twenty years has been at a rate

¹ New York.

which is regarded by many thoughtful observers with alarm as imperiling not only our liberties but the very solvency of the state.

The particular subject of public service commissions furnishes an instructive illustration of this tendency towards bureaucracy in our national and state governments. The Federal Interstate Commerce Commission, which began its work in 1887 with a staff of a few secretaries, stenographers and messengers at an annual expenditure of \$97,800, has developed into an immense bureau with an organization of 2,500 employees, and its maintenance now calls for an annual appropriation by Congress of nearly \$5,000,000. So, likewise, our own Public Service Commission for the first district, which began its activities only nine years ago with a staff of 326 employees and an annual expenditure of a few hundred thousand dollars, is now operating with an organization of 2,300 employees at an annual cost of more than \$3,600,000, although this staff and expense will, it is expected, be curtailed as soon as the pending rapid transit construction is completed.

Almost every state in the Union has similarly created regulatory commissions under varying names, such as public service, public utilities and railroad commissions. Not only the legislative bodies, but all of these commissions are constantly at work regulating the use of private property and exercising a control over business that is being gradually extended and broadened and made more and more oppressive year after year. Indeed, as Chief Judge Cullen warningly said in one of his opinions¹: "The great misfortune of the day is the mania for regulating all human conduct by statute, from responsibility for which few are exempt, since many of our most intelligent and highly educated citizens, who resent as paternalism and socialism legislative interference with affairs in which they are interested, are most persistent in the attempt to regulate by law the conduct of others."

¹ 204 N. Y. 534; 1912.

In our own state, during the past five years our legislators have enacted 3,555 separate statutes covering 11,674 printed pages of laws. The fruits of the labors of the pending session at Albany are not yet known. President Elliott, of the New Haven Railroad Company, in his recent address at Washington before the Chamber of Commerce of the United States, declared that "from 1909 to 1915 the states enacted 60,001 and Congress enacted 2,013 new laws which involved the consideration of more than one-half million legislative propositions, or an annual production of over 12,000 new laws to be assimilated by the business world," and that "the Sixty-Third Congress alone considered 30,053 bills and enacted 700." The total cost to the taxpayers of the country of the regulation of business by direct legislation and by commissions is stupendous; but, in addition to this more or less common burden imposed on the taxpayers of all classes, there is further imposed upon the businesses regulated an enormous expense in complying with statutory and administrative regulations sometimes of no practical benefit to any one, and frequently a hindrance to business. The single item of the voluminous reports and statistics which the national and state commissions require to be furnished involves an annual expense of millions of dollars to the industries being regulated. In fact, the cost of regulation so far has been out of all proportion to the service rendered by these commissions, the protection afforded, or the benefit secured.

Whilst in many respects the regulation of business by commission is still experimental, and it has yet to be proved that any such extensive and complicated bureaucratic system can be successful, or that these bodies are competent to exercise beneficially and satisfactorily the far-reaching jurisdictions and vast powers already vested in them, they are nevertheless at almost every session of Congress or state legislature having granted to them still more extensive jurisdiction and still greater powers and duties of regulation and control. They are being compelled to undertake such multifarious tasks and to perform

functions so complex, so comprehensive and so gigantic in scale as to be quite beyond the capacity of any one body of men however talented, and the commissioners are forced to neglect many of their functions and to rely upon subordinates for the performance of many of their duties. The commissions are being paralyzed by having altogether too much to do and by attempting to deal with too many non-essential details. In truth, they are finding themselves unable to see the forest because of the trees.

Statistics taken from the latest annual report of the Interstate Commerce Commission submitted to Congress for the year ending October 31, 1915, will show the extent to which the federal body is being overwhelmed and swamped. The commission during that one year conducted 1,543 hearings in the course of which it took 200,438 pages of testimony. It heard oral arguments in 198 cases; it decided 902 cases upon what it terms its "formal docket"; 6,500 separate complaints were entered upon its "informal docket" and 6,690 applications upon its "special docket," and it made 822 orders under the "long-and-short-haul" clause. No less than 149,449 rate schedules were filed with it, which in theory at least the commission is supposed to examine and digest, that is, an average of 500 rate schedules per working day. The report of the commission then adds, perhaps protestingly, if not despairingly, that "a mere recital of these figures scarcely gives an adequate idea of the volume of work disposed of and the enormous interests involved in the cases that came before the commission." Yet, at the present session of Congress it is proposed to increase the duties of the commission still further by vesting in it control over corporate finances and the issuing of corporate securities and by greatly extending its inquisitorial powers. One of the pending bills, for example, would grant to the commission and its special agents and examiners access to all the "accounts, records, memoranda, correspondence, documents, papers, and other writings, and indexes thereto, regardless of

the dates thereof, relating to financial transactions of, for, or with [any] carrier, and kept or preserved by or for, or in the custody or under the control of . . . any director, stockholder, officer, agent, attorney [and] employee" as well as of "any other person, persons, corporation, joint-stock company, or corporate combination having, or having had, any financial transactions with or for [a] carrier." This sweeping power is to be conferred under the notion that it is necessary in order to enable the commission to determine what are reasonable rates.

The next step to be taken — and this is being strenuously advocated by the champions of the commission system — will be to grant power to the Interstate Commerce Commission to fix the wages of railroad employees, on the ground that this is an item of paramount influence in the cost of the service rendered by carriers and of much more importance in rate-making than the issuing of securities or the rate of interest payable upon money borrowed by corporations. It is argued that the granting of this additional power would accord with justice and common sense, that it is absolutely necessary for the protection of the public who use the railways, and that, as the commission now regulates rates and exercises broad and far-reaching supervision over the business of the carriers, it should regulate employees as well as employers and be in a position to say whether or not the wages of engineers, conductors, firemen, trainmen and track workers should be increased or reduced. The same reasoning would, of course, include all the supplies and equipment of railways and the wages of those producing them. American labor may some day find that, under the euphemistic nomenclature of arbitration made compulsory by law, we have drifted into enacting a new form of the English Statute of Labourers. And the commission would then find itself the storm-center of industrial disputes, with all its time and attention engrossed in investigating and determining what it should adjudge to be reasonable wages for railroad employees in every state of the Union under infinitely varying conditions.

The work of the New York Public Service Commissions — at least in the first district — is scarcely less onerous and multifarious than that of the Interstate Commerce Commission. Indeed, the jurisdiction of the New York commissions is much more extensive, for it applies not only to carriers by railroad but to the varying and dissimilar businesses of street railways, telegraph and telephone lines, gas and electric light and power plants, steam plants, stockyards, stages and busses, and other public utilities, including in the first district the construction of rapid transit facilities. The New York commissions also supervise and control the issuing of corporate securities, reorganizations, transfers of franchises, etc., and are constantly employed in the exercise of judicial powers and in the determination of extremely complicated questions of law and of fact. The commission in the first district in its latest report states that during the year 1915 it received 5,732 complaints and held 812 hearings in 337 "formal cases." But these hearings constituted only a small part of the work of the commission. To mention only a few other items, the commission in the first district reports that it supervised generally the business of 102 public service companies having an aggregate capital of \$1,325,273,548, not including certain holding companies and trunk line railroads which are under the jurisdiction of the commission as to certain special matters; that it inspected, in 236 manufacturing plants located in 143 towns and cities scattered through 17 different states, construction material valued at \$11,500,000; that it maintained a chemical laboratory for the testing of materials; that it awarded subway contracts aggregating \$26,000,000, bringing the total of these contracts up to about \$168,000,000; that it passed upon applications for issues of corporate stocks and bonds and authorized the same to the extent of \$23,000,000, making the total amount of the issues thus authorized \$635,159,477, and that it tested 383,401 gas meters during the year 1915, bringing the total number of meters tested up to 3,088,155. In addition to these vast

administrative details, the supervision of the subway construction, and very extensive and difficult judicial labors, more than sufficient, if thoroughly done, to have engrossed all the time and thought of a dozen commissions of trained experts, the commissioners were constantly formulating rules and orders, with the power to make disobedience to their orders or fiats a criminal offense and punishable as such.

The powers originally vested in the Interstate Commerce Commission by the Act of Congress of 1887 were quite sufficient for any one body to exercise; but these powers have been so extended and are so varied as to create a volume of work beyond the capacity of any one commission. The powers now vested in and exercised by the New York Public Service Commissions, particularly the commission for the first district, and the varied duties they attempt to perform are likewise beyond the capacity of any single body of five members, or even half a dozen such bodies. They are expected to supervise and solve the most difficult and intricate problems of corporate finance and the issuing and refunding of corporate securities and the reorganization of corporations. They must fix reasonable rates in the varying businesses under their control. They are expected to regulate the management of innumerable details of many complex businesses. They must determine intricate questions as to the operation of all classes of public utilities. They must have encyclopedic knowledge and talents such as no one board of directors could rationally be expected to possess. They constantly substitute their judgment as to business questions for the judgment of the trained and expert managers of the 102 corporations regulated. The supervision of the dual subway enterprise alone, during the period of promotion, experiment and construction, involved the greatest municipal undertaking in history and a task of the utmost complexity and difficulty, and required exceptional expert knowledge and constant and strenuous labor sufficient to engross the time and attention of the five commissioners; yet

the commissioners, busy if not overwhelmed with innumerable other important and difficult tasks, were compelled to take up this stupendous additional task and to act in the capacity of negotiators, financiers and expert engineers. A great business concern, for example the Pennsylvania Railroad Company, would, of course, have placed the supervision of the planning and construction of such a system in charge of trained engineers of experience and established reputation — experts of the standing of Mr. Barclay Parsons, Messrs. Jacobs and Davies, Mr. Bion Arnold — and certainly would not have turned the whole matter over to a commission or committee composed of five members, not one of whom at that time had ever had any technical training or practical experience in such work.

That the commissions are being overburdened and overwhelmed with the many tasks imposed upon them has long been recognized by those who are familiar with the system and competent to judge. In an address delivered in 1907, Commissioner Prouty, of the Interstate Commerce Commission, used the following language: "If the Interstate Commerce Commission is vested with a jurisdiction so tremendous in extent, and of such finality, every effort should be made to provide a body adequate to the trust. . . . I very much doubt whether the same body can properly discharge both these functions [executive and judicial]. In the end it will either become remiss in its executive duties or will, in the zeal of these, become unfit for the dispassionate performance of its judicial functions. Whatever may have been true in the past, the time has come when the commission should be relieved of all its duties except the hearing and deciding of complaints."

This and similar advice and admonition have been wholly disregarded, not only by Congress but by the state legislatures. Despite the enormous burden of executive, administrative and judicial duties existing in 1907, the powers of the Interstate Commerce Commission have since then been increased, and it is exercising in an ever extending measure the most far-

reaching legislative, executive and judicial functions. This is equally true of the state commissions. In my judgment the fact that the commissions have become ineffective and discredited in public opinion is due principally to their being overburdened and overwhelmed with a multiplicity of tasks and a mass of extremely difficult and complicated duties which they cannot possibly perform in any satisfactory manner. As a consequence, to quote what a distinguished statesman recently declared, "the very name 'regulation' has become an offense and an abomination to many honest business men."

I, therefore, submit that the first step to be taken is to limit the functions of these commissions to fewer and simpler tasks, which will be within the capacity of one body of five or seven or nine men to attend to intelligently and competently.

In the inspiring address which Mr. Justice Hughes delivered before the State Bar Association in January,¹ he must have had particularly in mind our public service commissions when he said that "the ideal which has been presented in justification of these new agencies, and that which alone holds promise of benefit rather than of hurt to the community, is the ideal of special knowledge, flexibility, disinterestedness and sound judgment applying broad legislative principles that are essential to the protection of the community and of every useful activity affected, to the intricate situations created by expanding enterprise. But mere bureaucracy — narrow, partisan, or inexperienced — is grossly injurious; it not only fails of the immediate purpose of the law and is opposed to traditions which happily are still honored, but its failure creates a feeling of discouragement bordering on pessimism which forms the most serious obstacle to real improvements in the adjustment of governmental methods to new exigencies."

It must be apparent that, above all other considerations, the ideal as well as the indispensable condition, if we are reasonably

¹ 1916.

to expect success in this new governmental departure and experiment, is *special knowledge*, that is, knowledge which comes from technical training and practical experience, which the public at large does not possess, and which it cannot in the very nature of things be expected to possess. This special knowledge is ordinarily to be found only in trained experts. In an interesting and able article in the *World's Work* for February,¹ a competent critic, the well-known banker, Mr. Kahn, states that although the Interstate Commerce Commission "has greater powers and greater responsibilities concerning the industrial life of the nation than probably any other tribunal anywhere in the world exercises, there has never yet been appointed a man who came to it qualified by first-rate experience in railway operation, or by broad business experience, or any considerable experience in financial matters." A ray of light and promise appears in the Federal Reserve Banking Act, which provides that the "Federal Reserve Agent" of each bank must be a person of "tested banking experience." This is a precedent to be followed.

In nine years we have had in the first district fourteen public service commissioners, most of whom were lawyers by profession. Yet not one of these gentlemen before his appointment, so far as I have been able to ascertain, had had any special knowledge of any of the various complicated businesses over which he was to exercise the most extensive powers of supervision and control. Certainly none of them had such expert knowledge derived from technical training or practical experience in these matters as would have warranted any large private concern in placing such comprehensive powers in his hands. Only one of the present commissioners has been in office a year, and his training when appointed had been that of a lawyer with little or no practice or experience in the particular industries he was to regulate. I am not disparaging his talents or his ability as a lawyer. I am simply pointing out that he

¹ 1916.

was not an expert and did not have the special knowledge which Mr. Justice Hughes recognizes as indispensable and which, he says, alone holds out promise of benefit rather than of hurt to the community. Four of the present commissioners have been in office but a few weeks. It is true that they are men of ability and character, but none of them is really an expert in any one of the businesses which the commission supervises and regulates. Mr. Hodge is a capable engineer of experience and established reputation but has, I understand, had little to do with the particular businesses he will now supervise. Although Mr. Whitney as secretary of the commission undoubtedly acquired much information which must be of great service to the commission and the public, nevertheless I doubt whether he would seriously class himself as a trained and experienced expert in any one of the businesses placed under the regulation and control of the commission. The distinguished and public-spirited chairman was trained as a lawyer; but he withdrew from practice thirty-five years ago to enter private business, and his business experience and public work since then have not been such as to give him special knowledge of any of the businesses under the jurisdiction of his commission. I am informed that he candidly so stated when he accepted the appointment. Moreover, none of the present commissioners could reasonably be said to have had such training in the law of this state as we would deem essential for high and important judicial office; yet they will all sit day after day in hearings essentially judicial in their nature ruling upon difficult controverted questions of law and fact of vital interest, not only to the public but to the 102 corporations regulated, and their rulings upon the admissibility and credibility of testimony as well as upon all inferences warranted by the evidence and their findings and conclusions of fact will be practically conclusive.

We must concede, of course, that it is extremely difficult to induce competent, trained and experienced experts to serve on such commissions and that we have not yet devised a civil

service system which will invite men of first-class ability to make their life careers in the permanent public service, as in Europe and British India. How we shall bring this about is the great problem of government facing us to-day.

President Lowell of Harvard in his lectures on "Public Opinion and Popular Government" urges the recognition of the imperative necessity of having experts in our government service, national and state. He says that we are now training men for all professional work except that of the government. Speaking of administrative offices, he points out that "they require quite as great skill as many positions in private employ to which one would not think of appointing an untrained man," and that we are "intrusting such duties to a periodically shifting body of officials drawn for political motives from an inexperienced public." He adds that "in many branches of the public service, central and local, we have no experts at all, no permanent officials playing an important part in the administration, and that even in those matters . . . where experts are regularly employed we rarely allow men to remain in office long enough to acquire that familiarity with their peculiar problems which confers efficiency and authority." He declares that "the United States is the only great nation with a popular government to-day which has not permanent officers of that kind," and that "it is they who keep the machinery of government elsewhere in efficient working order."

And President Goodnow of the Johns Hopkins University in his work on "Politics and Administration" also urges the imperative necessity for experts with special knowledge and training. Although he doubts that the securing of experts in the higher posts of public service can be accomplished by any changes in the law, he nevertheless believes that this will be brought about through the appointing power when an educated and intelligent public opinion shall demand it.

We lawyers might do much to educate public opinion in this respect. We are better qualified to lead in these matters than

any other class. We have stood altogether too much aloof from these public problems. Commissioner Whitney may be justified in complaining, as I am informed he recently did, of the failure of the bar of the City of New York to help the Public Service Commission with constructive suggestions. A joint committee of the bar associations of the state would render a great public service by making a thorough, impartial, and exhaustive investigation of this whole problem of public service commissions and pointing out the crying need for experts in our public service. This is a task worthy of our profession and one which would enable it to render a great and patriotic service to the nation and the state. Progress and efficiency in the future, as our conditions become more and more complex, will only be found in the advice and direction of men qualified by study and experience to advise and point out the way, and certainly not in the haphazard experiments with which our representatives in public office are now groping and blundering.

But, in the meantime, as at present the difficulty of securing public service commissioners who are really experts and who have special knowledge of the particular businesses to be regulated seems to be almost insuperable, should we not limit the powers of these commissioners to simpler tasks and duties, such as they can be reasonably expected to perform for the protection and benefit of the public? If the jurisdiction of our public service commissions were now limited to fewer matters and the commissions were made strictly administrative bodies without judicial powers, they would be able to render much more effective, valuable and satisfactory service to the public than is now possible. Mr. Coleman, after more than eight years of exceptional opportunities for observation and study, has indicated the true lines to follow, that is, to limit the powers and efforts of the present commissions to two fundamental objects, namely, securing safe and adequate service and just and reasonable rates. These two objects are sufficient to keep any com-

mission busy. All collateral matters, including problems of corporate finance, should be excluded, or vested in separate bodies, even though these collateral matters constitute elements indirectly affecting service or rates. For example, the actual or nominal capitalization of a corporation need have no relation to what ought to be the controlling question of the actual value of property devoted to a public use or the actual cost of construction or duplication. Why then waste day after day in taking testimony as to discounts on securities, market rates of interest, profits of promoters, and other financial details? A reasonable rate of charge — reasonable for the public as well as for the owner of the utility — can be determined without litigating these collateral issues.

Firmly believing that what we need in our public service commissioners is less of the judge and more of the expert, I want to emphasize particularly that public service commissions should not be permitted to exercise judicial power. These bodies are not constituted for the due and impartial performance of such duties. The elimination of judicial power would not impair the practical usefulness or efficiency of the commissions. On the contrary, in my judgment, both the Interstate Commerce Commission and the commissions of the several states would accomplish more than they are now accomplishing and render better and more efficient service to the public if they did not exercise judicial powers and did not act at the same time as party, prosecutor and judge in so many cases before them.

A single commission cannot properly discharge administrative and judicial duties at the same time, and our commissioners are generally not qualified to exercise judicial powers. Commissioner Prouty's remarks as to the Interstate Commerce Commission apply equally to our public service commissions, as every lawyer who has appeared before them must have realized. In the zealous performance of their executive

duties, in their championing of the interests of the public, which they properly feel are especially confided to their care, in the prosecution of complaints instituted by themselves, in their natural endeavor to establish the correctness of their own preconceived and frequently predeclared views and policies, they become unfit for the dispassionate performance of judicial functions, and they therefore inevitably deny to parties before them the fair trial before an impartial, unbiased and competent tribunal to which every one — every class in the community — should be entitled as of absolute legal right. Such commissions ought to have no concern but the public good and no personal interest in the questions before them; but at present they are placed in the false position of being litigants fighting for their own advantage or for their own views or policies.

Under the existing system, in many instances the sitting commissioner or the commission itself necessarily becomes what an English writer has called "that judicial monster, a judge in his own cause." In nearly all controversies before the commissions, on one side will be found their own employees and counsel as the prosecutors or adversaries of those whose property rights may be materially affected, if not ruined, by the decision. Constituted as humanity is, the commissioners must be unconsciously biased in favor of their own associates and subordinates. Frequently, if my information be accurate and I believe it is, the commissioners, federal and state, sitting as judges direct the preparation of the evidence to be adduced before them and privately confer in regard to the particular case or complaint in hand, not only with their own associate or subordinate appearing before them as counsel for the commission but with their own employees who are to testify as witnesses. The commissioners and their employees necessarily become partisans. The whole atmosphere is the negative of what a court of justice ought to be. Under such circumstances, it is simply preposterous to expect in cases or complaints or hearings before commissions that impartiality, open-minded-

ness, disinterestedness and sound judgment which are indispensable in a judge and essential to evenhanded and unbiased justice as we lawyers understand that term.

It cannot well be denied that the Interstate Commerce Commission and other public service commissions are constantly exercising judicial powers, and that there is seldom any effective judicial review of their rulings. The essential nature of their acts of power is not, of course, to be changed by calling them quasi-judicial or by any other nomenclature. The power to hear evidence and decide a controverted question of fact is a judicial function just as much as the power to decide a question of statutory construction or other question of law. In the recent Federal Trade Commission Act¹ it is expressly provided that "the findings of the Commission as to the facts, if supported by testimony, shall be conclusive," thus practically withdrawing such decisions from judicial review. The theory upon which this exercise of judicial power is being allowed under the Federal Constitution, which separates the judicial from the legislative and executive powers, is that performance of judicial duties may be vested in executive or administrative officers where such power is merely incidental to the execution of functions peculiarly administrative.

The Supreme Court has, it is true, gone very far in upholding such grants of judicial power to administrative bureaus, as notably in the *Fraud Order* and the *Chinese Exclusion* cases. The present rule, as it seems to me, must ultimately be limited along the lines indicated in the dissenting opinion of Justices Brewer and Peckham in the *Ju Toy* case,² because it will sooner or later become intolerable that administrative officers should be vested with essentially arbitrary and autocratic powers in respect of disputed questions of fact affecting the personal and property rights of individuals. I profoundly believe, with all deference to the court, that the spirit of the Constitution is

¹ 38 U. S. Stat. at Large, 717.

² *U. S. v. Ju Toy*, 198 U. S. 253; 1905.

being violated in the exercise by the Interstate Commission of much of its judicial power, and that true of other departments of the national government. The Supreme Court has held that the findings of the Interstate Commerce Commission, if supported by substantial evidence, are conclusive and cannot be reviewed by the courts. From this ruling that in many of the proceedings of the commission, where every element of a judicial proceeding is found and where the commissioners act as judges and exercising judicial power, the action of the commission becomes a practical finality, to Prouty's expression, and parties are frequently denied review before a court of justice of the ruling of the commission. In other words, the very evils which were sought to be prevented in the Constitution by adopting the principle of separation of powers and law obtaining in the seventeenth and eighteenth centuries, judicial power should be exercised only by the law whose term of office should be limited and who would for that reason be more independent of the executive.

It is true that it has for many years been a part of constitutional law that the ultimate finding of fact by a commission, whether federal or state, for efficiency of particular rates, could not be reviewed. The same result, however, is being in many cases accomplished indirectly by giving a practical effect to the findings of commissions upon evidence of fact and the inferences to be drawn from them. A rule making the finding prima facie correct, or creating a rebuttable presumption of support would not, of course, necessarily deprive a party, for it would operate generally to shift the affirmative of the issue and the burden of proof would frequently be no more than

testimony or procedure. We can ordinarily acquiesce in a rule by which appellate courts shall not review the conclusions of fact or conflicts in testimony in the lower courts, because in such cases we have had at least our one day in a court of justice proceeding according to those long-established rules and safeguards of evidence which we believe to be essential for the ascertainment of the truth, the protection of individual rights, and the impartial and competent administration of justice. In this state,¹ by virtue of our Code of Civil Procedure (section 2140), the findings or conclusions of fact of our public service commissions must be given as much force and effect as the verdict of a jury after a judicial trial.

If, therefore, the findings or conclusions of fact of administrative boards are not to be susceptible of full review by the courts, and if they are to be made practically conclusive whenever there is any evidence to support them, there will then be in the majority of cases a complete denial of any fair trial in a court of justice as much as if the ultimate ruling or decision of the commission were also made conclusive. It is, of course, well known that many, if not most, of the cases before these commission tribunals depend in final analysis upon the facts, and that, if the facts are not to be reviewable in the courts, the decisions of the commissions will in such cases become final. This will become more and more the practical result as the statutes are authoritatively interpreted by the courts and all questions of mere legal power and procedure definitely settled.

The doctrine that all findings of fact of an administrative commission are to be treated as sacrosanct is in many respects both absurd and dangerous. Indeed, it seems to me that it was a mistake to permit any departure from the principle of constitutional law denying the power to give conclusive effect to the findings of commissions. An aggrieved party should have at least one day in court, and, when appealing to a court

¹ New York.

of original jurisdiction for justice, should not be prejudiced or handicapped by any findings or conclusive presumptions, whether of fact or law, against his contentions in that court. Otherwise, we shall have no real judicial protection against arbitrary and unjust action by commissions.

The power to determine conclusively all controverted questions of fact now vested in these bodies has undoubtedly impelled the courts generally to hold the commissions to the most technical rules of law affecting the rights of parties and to require competent proof of all the facts necessary to be proved in order to authorize the making of a determination. The result is that the conduct of proceedings before these commissions is becoming more and more technical and formal; administrative efficiency is thereby being cramped and diminished, if not frequently paralyzed, and procedure is beginning to receive even more attention than matters of substance and the merits. As Mr. Coleman put it, procedure in this administrative field is full of pitfalls, trenches and barbed wire. Every order of a commission must be supported by findings of fact ascertained and proved by competent evidence in each particular proceeding as it affects the party regulated and contesting. The statutory provision generally inserted that these tribunals shall not be bound by the technical rules of evidence, I venture to say, has only complicated the performance of their duties and has been of little practical help, for legal evidence must still be adduced in order to support any finding. Professor Wyman has said that "the more liberal the practice in admitting testimony, the more imperative the obligation to preserve those essentials of action in accordance with evidence adduced by which rights have immemorially been asserted or defended." The commissioners may have the most accurate expert and special knowledge of the situation presented by the case or complaint then before them; they may have a few weeks before concluded a thorough investigation of the subject in all its aspects and at great expense and delay; they may know all

the material facts with reasonable certainty; prompt action may be advisable and they may be fully prepared to act; but they must nevertheless in each case proceed anew to hear and consider and rule upon every particle of evidence relevant or irrelevant which counsel may offer to adduce. Hence the great mass of information which the commission is laboriously accumulating year after year is not available to it as evidence upon which to base an order in any contested case in hand.

On the other hand, if the commissions were not exercising judicial powers, they would have far greater liberty and facility of action. They could then be safely constituted entirely of experts, and they could be charged with the sole duty of acquiring special and accurate knowledge as to all so-called public utilities and of formulating rules as to public safety and convenience, as to public service, and as to rates of charge, which rules could be made *prima facie* correct and binding, with liberty to the corporation or individual affected to challenge them as unreasonable and to test that issue in the courts. Full powers of investigation should be continued so that the commissioners may thereby readily acquire the special knowledge they need. The commissioners or their subordinates should continue at liberty to make informal investigations and to avail of any information they have, and base rulings thereon after notice to the party affected and a concise statement of the grounds upon which they are proceeding. Any one affected should be compellable and should have the right to furnish information on any such investigation, but should not be entitled to a formal judicial hearing before the commission with the technical procedure and competent evidence that that always implies.

Although the principle of the separation of governmental powers was long observed in this country in its integrity and is still generally recognized as a sound governmental policy, we must perceive that it is being gradually undermined in national and state affairs. The constitutional rule as to the federal

government is different from the rule obtaining in some of the states,—for example, in this state. The Federal Constitution separates the judicial power by expressly vesting it in courts of justice constituted of judges appointed during good behavior, and if that provision be followed according to its intent and spirit, the separation will be maintained. The New York state constitution, however, does not separate the judicial power from the other branches of government, and therefore in this state administrative boards may be vested with the fullest and broadest judicial powers; and their rulings, even on questions of law, may be made final and conclusive without any right of appeal to the courts. The Supreme Court of the United States has declared that neither the fourteenth amendment nor any other provision of the Federal Constitution forbids a state from granting to an administrative body the final determination of questions of law or of fact, and all that is necessary is to afford a hearing before final determination.

It is interesting to note that the same tendency to invest administrative boards with judicial powers and to supersede and undermine the law courts by bureaucracy has also been developing in England and, notwithstanding the supremacy of Parliament, is being challenged there as involving a grave menace to the principle of the supremacy of the law and to the rights of the individual. The Master of the Rolls, Sir H. H. Cozens-Hardy, in a speech at the Guildhall banquet of November 9, 1911, referred to the tendency in recent years to remove from the courts matters which properly belonged to them, and to intrust them to government departments, and he solemnly expressed the view that this was a great mistake. The British Constitution Association has issued a protest against this practice, characterizing it as vicious and insisting that bureaucratic decisions are certain to be biased and unscientific. Many lawyers in England declare that trials before such tribunals are a denial of the fundamental right or privilege of a fair trial

before competent and impartial judges guaranteed to Englishmen by Magna Carta.

The bureaucratic development in England and the tendency to withdraw from the courts matters essentially proper for judicial review and protection coincide closely in time with our own development of administrative bureaus. The encroachment of the administrative on the judicial department there is to be traced back to a section in the Public Health Act of 1875. This section had to do with sewage and drainage, and it provided that any person feeling himself aggrieved by any assessment might address a memorial to the local government board, and that any order made by this board should be binding and conclusive on all parties. This provision of the Public Health Act was the parent and prototype of all the statutory inroads that have since been made on the powers of the law courts in England. It was reproduced almost verbatim in the Education Act of 1902, which virtually placed the children of England under the absolute control of a governmental bureau. An extreme example of the encroachment of the administrative upon the judicial department in England will be found in the National Insurance Act of 1911. This statute places the independence and happiness of the poorer classes in many respects within the power of a bureaucratic organization without any right of appeal to the courts.

In writing the introduction to the latest edition of his "Law of the Constitution,"¹ published last year, Professor Dicey, the great English authority on constitutional law, took occasion to deprecate the growth of bureaucracy in England and the decay of the great English principle of the rule of law administered by courts of justice. He compares the development in England with that of France. He shows that whereas in England the recent development, contrary to all constitutional precedent, has been away from judicial control towards an arbitrary bureaucracy, in France just the opposite development

¹ 1915.

has been taking place. There the tendency has been to check and control the bureaucracy by means of responsible judicial bodies which protect individual rights against the encroachments of administrative officials. Dicey says: "And it may not be an exaggeration to say that in some directions the law of England is being 'officialized,' if the expression may be allowed, by statutes passed under the influence of socialistic ideas. It is even more certain that the *droit administratif* of France is year by year becoming more and more judicialized." Thus, in England, as in America, the people are drifting from the courts of justice as the bulwark of their liberties and the only fit instruments for curbing executive tyranny, and are placing arbitrary and autocratic powers in the hands of administrative officials generally untrained in the law and uncontrolled and unchecked by judicial review.

Those who advocate conferring judicial powers on these public service commissions without right of review in the courts frequently refer to the efficient French administrative departments and the so-called French administrative courts as an example of what may be accomplished by administrative officials. It is said that in France the courts are not allowed to interfere with administration, and that there the individual is afforded no right to question in courts of justice the orders or acts of administrative bodies. Unfortunately, for the purposes of this argument, the statement is not strictly accurate. Although the famous act of 1790 prohibiting the ordinary courts from interfering with administrative officials is still in force, there is nevertheless an appeal from administrative officials to the French Council of State, the highest administrative tribunal in France, and the Council in one of its branches is now organized as an independent court of justice entirely separate from its organization as an administrative body. The individual whose rights have been infringed by an administrative official may carry his alleged grievance to the Council of State as the

court of last resort, and thus get a final review of his case by a judicial body acting according to orderly judicial procedure and reasoned judgment, based on established rules and precedents.

Most of the progress made by the French towards judicial review of the acts of administrative officials has taken place under the Third Republic. It was by the law of May 24, 1872, that the Council of State was given its character as an independent court of law, and that the present Conflict Court was created. The Council of State has since then been so liberal in finding grounds to protect the rights of individuals and in checking or restraining any arbitrary, oppressive, or unjust action on the part of administrative officials that to-day the humblest citizen in France, at a trifling expense, may judicially question the act of any administrative or executive official, from a constable to the president of the Republic. In the protection of individual rights the French Council of State has repeatedly annulled acts and orders of the highest governmental departments and even of the president himself. Under the administrative system as now developed in France, the private citizen has probably a greater measure of protection by judicial bodies against arbitrary, unjust, or illegal acts of government officials than in any other country. In a word, since 1872, the whole tendency in France has been toward judicial control. The use of the word "administrative" is apt to mislead us. Though in their origin the present French administrative courts were strictly administrative bodies, to-day they are truly courts of justice, offering all the guaranties afforded by fixed rules of law enforced by learned, impartial and independent judges. The people now look with confidence to these tribunals for the protection of their legal rights and regard them as essentially judicial. It has been found in France, as it will be ultimately found with us, that private rights can be afforded full protection under the rule of law impartially enforced by independent judicial tribunals without unduly interfering with or hampering administrative efficiency.

I find it impossible within the limits of this address to deal satisfactorily or comprehensively with such a large and important subject as the regulation and control of public utilities by means of administrative commissions, and particularly the aspect of judicial review. I can do no more than suggest some points for reflection. It seems to me that the theory of regulation by commissions is inherently sound. Large legislative bodies such as Congress or our state legislatures cannot act in these matters so intelligently and competently as a board or commission of trained experts. The people at large must be protected against those who are engaged in certain businesses in which the public is interested and upon which the public must depend. The managers of these concerns generally have it within their power to oppress the public and make a prey of their necessities. But it should be recognized that such bodies as these commissions are not fitted or qualified by training or temperament for the exercise of judicial power. The corporations and individuals whose businesses are regulated, whose earning capacity may be destroyed, or whose property may be practically confiscated by unwise and unjust regulation, ought to have a day in court as of right before an impartial judicial tribunal composed of men learned in the law and bound to decree justice according to law. If this involves delay and expense, it is far better to submit to that inconvenience than to withdraw the protection of the law from any class in the community. The example or precedent is altogether too dangerous. Neither expedition nor economy has resulted or ever will result in the long run from disregarding fundamentals and confusing powers which in their nature and in their proper exercise are radically different and require different treatment and different points of view.

I am not prepared to say that it would be wise or unwise to create special courts similar to the French administrative courts, or our Court of Claims, or the ill-fated and short-lived Federal Commerce Court. I recognize also that it is by no means

certain that the ordinary law courts are in all cases the best bodies for adjudicating upon the errors or abuses of administrative bureaus. Some exceptions may be necessary. However, generally speaking, my own view is that it would be better and more satisfactory to afford full review of all essentially judicial questions in our regular courts, in view of their learning and training, their long-established prestige, and their moral authority. We might well create special divisions of such courts to hear and determine controversies relating to orders or regulations of our public service commissions. For example, our Court of Claims would probably be a more satisfactory tribunal if it were composed of Supreme Court justices and were organized as a branch or division of that court. A study of the decisions of our ordinary superior courts, federal and state, in cases involving the most complicated problems ever submitted to commissions, such as the Minnesota and Missouri Rate Cases ¹ and *People ex rel. Kings Co. Lighting Co. v. Willcox*,² must convince us that they are fully competent to deal with all judicial questions likely to arise from time to time in the administration of federal and state commission laws. In most cases much more expedition and economy would be secured if long and formal hearings before commissions were dispensed with and if controverted issues about to be litigated were at the outset taken into a court of justice. A plain and concise statement of the grounds upon which an order of a commission has been based ought to be sufficient to enable the courts to test the contention of the individuals or corporations affected that such order is unreasonable or illegal.

Finally, I venture to predict that the continuance of the present tendency towards vesting judicial power in these administrative bureaus, unless checked, will defeat the whole experiment of public service commissions. The American people will not long be content with having their rights conclusively determined by administrative fiat, but will inevitably

¹ 230 U. S. 352, 474; 1913.

² 210 N. Y. 479; 1914.

turn back to the courts of justice and insist upon a judicial trial, with its guaranty of a fair hearing, and will demand reasoned judgment consistently applying ascertained general principles and precedents and excluding official discretion with its danger of action dictated by caprice, prejudice, or passion. We will not permanently tolerate despotism in any form, however temporarily expedient or benevolent. The corresponding risk of ultimate arbitrary power and bureaucratic tyranny is altogether too great. In the last analysis, the survival of self-governing democracies and what our fathers termed regulated liberty will depend, as English and American history ought surely to teach us, upon the separation of the judicial power in nation and state and upon its freedom from executive and political control, in a word, upon its complete independence, but above all, if I may recall the immortal language of *Magna Carta*, upon its exercise only by judges "such as know the law of the realm and mean to observe it well."

INDEX

- American Malt Corporation, reorganization, 218
- Antitrust Laws
 Clayton Act. *See* Clayton Act
 Federal Trade Commission Act. *See* Federal Trade Commission Act
 Sherman Law. *See* Sherman Anti-trust Law
- Baltimore & Ohio Railroad
 Mortgages, 5, 6, 8
 Reorganization, 177
- Bondholders' Protective Committees, 162
- Bonds
 Collateral Trust Indentures, 57
 Debenture Indentures, 66
 Guaranties, 70
 Historical Development, 1
 Income bonds, 69
 Mortgage Regulating Issue, 27
 Protective Committees, 162
 Stock Exchange Rules as to, 71
- Brewer, Mr. Justice; extract from opinion in *Merchants Loan & Trust Co. v. Chicago Rys. Co.*, 190
- Buffington, Judge; extract of opinions on Sherman Antitrust Law, 253, 254, 255
- Bureau of Corporations; reference to, in lecture on Federal Trade Commission, 312, 314
- Butler, Judge; extract of opinion on Sherman Anti-trust Law, 241
- Byrne, James; paper by, 77-152
- Cases Cited or Discussed. *See* Alphabetical List on page 379
- Chicago City Railway mortgage discussed, 33
- Clayton Act
 Lecture on, by Gilbert H. Montague, 275-326
 Reference to, in Lecture on Sherman Antitrust Law, 273
 Violations; procedure of Federal Trade Commission as to, 322
- Coleman, George S.; paper by, 327
- Collateral Trust Indentures, 13, 57
- Committees
 Protective; bondholders' and stockholders', 162
 Reorganization, 181
- Corporate Bonds, Mortgages, Collateral Trusts and Debenture Indentures; paper by Francis Lynde Stetson, 1-76
- Corporations
 Dissolutions under Sherman Antitrust Law. *See* Sherman Antitrust Law
 Recapitalization without insolvency, 224
 Reorganization on Insolvency
 With new Corporation, 156
 Without new Corporation, 209
- Cravath, Paul D.; paper by, 153
- Cullen, Chief Judge; extract from opinion in *Hoffer v. Britt*, 349
- Cummins, Senator; definition of "unfair methods of competition," 316
- Debenture Indentures, 6, 14, 66
- Dicey, A. V.; on bureaucratic development in England, 369, 370
 on the French *droit administratif*, 370, 371
- England
 Bureaucratic development in, 368-370
 Debenture holders in, rights of, 68
 Reorganization of corporations in, 188
- Federal Trade Commission
 Powers and duties, 312-315, 319, 325
 Procedure in respect of "unfair methods of competition," 320-322
 Procedure in respect of violations of Clayton Act, 322
- Federal Trade Commission Act
 Citation, in lecture on Sherman Antitrust Law, 270, 271
 History, 275-281
 Section 5: discussion on phrase "unfair methods of competition," 315-326

- Federal Trade Commission Act (*continued*)
 Section 5: procedure in respect of "unfair methods of competition," 320-322
- Federal Trade Commission and Clayton Act; paper by Gilbert H. Montague, 275-326
- Finch, Judge; extract of opinion in *Seymour v. Spring Forest Cemetery Association*, 224
- Foreclosure of Railroad Mortgages; paper by James Byrne, 77-152
- Foreclosures
 of Corporate mortgages generally, 153
 of Railroad mortgages, 77, 156
- French administrative departments, reference to, 370, 371
- Fuller, Chief Justice; extract of opinions on Sherman Antitrust Law, 241, 259
- Goodnow, Frank J.; on the need of experts in the government service, 359
- Government, growth of bureaucracy in England and America, 368-370
 need of trained experts in, 347, 356-370, 372
- Gray, Judge; extract of opinion on Public Service Commissions Law, 342
- Guaranteed bonds, 70
- Guthrie, William D.; paper on Public Service Commissions, 347-374
- Harlan, Justice; extract of opinions on Sherman Antitrust Law, 241, 242
- Harmon, Attorney-General; report to Congress on Sherman Antitrust Law, 243
- Hoar, Senator; remarks on Sherman Antitrust Law, 250
- Holding Companies, 230
- Hollis, Senator; definition of "unfair methods of competition," 317
- Holmes, Justice; extract of opinions on Sherman Antitrust Law, 250, 251, 260
- Hook, Judge; extract of opinions on Sherman Antitrust Law, 253, 256
- Hough, Judge
 extract of opinion in *Guaranty Trust Co. v. Inter. Type. Mach. Co.*, 189
 extract of opinions on Clayton Act, 299, 302, 303
- Hudson River Railroad mortgage, 2
- Hughes, Governor; extract from address and message pertaining to Public Service Commission, 327, 328, 329
- Hughes, Mr. Justice; extract from address before State Bar Association, 356
- Income bonds, 69
- Interstate Commerce Commission; reference to, in lecture on Public Service Commissions, 349, 351, 352, 354, 355, 357, 363, 364
- Interstate Trade Commission. *See* Federal Trade Commission
- Introductory Note, vii
- Judicial Code of U. S.; effect on foreclosure of railroad mortgages, 77, 92
- Judiciary threatened in England and America by growth of bureaucracy, 363-370
- Kahn, Otto H.; extract from article in *World's Work*, 357
- Kenna, Senator; remarks in debate on Sherman Antitrust Law, 253
- Lacombe, Judge
 extract of opinion on Clayton Act, 303
 extract of opinion on Sherman Antitrust Law, 267
- Lanning, Judge
 extract of opinion on Sherman Antitrust Law, 249
- Lowell, A. Lawrence; on need of experts in the government service, 359
- Lumbering Companies mortgages, 30
- Lurton, Judge
 extract of opinion in *Central Trust Co. v. Cincinnati H. & D. Ry. Co.*, 133
 extract of opinion in *Horn v. Pere Marquette R. Co.*, 91
- Massachusetts trusts, 232
- Metropolitan Traction Company, reorganisation, 231
- Mining Companies mortgages, 30
- Mohawk & Hudson Railroad mortgage, 2
- Montague, Gilbert H.; paper by, 275-326

Mortgages

Discussed

Baltimore & Ohio R. R., 5, 6, 8
Chicago City Ry., 33
Erie Railroad, 5, 7-10, 12
Hudson River Railroad, 2
Mohawk & Hudson Railroad, 2
N. Y. Central Ry., 33
Northern Pacific Ry., 12, 33
Richmond & Danville Railroad, 7
Richmond & West Point Terminal Ry. & Warehouse Co., 12

Foreclosure

Corporate generally, 153
Protective committees, 162
Railroad, 77, 156

Historical development, 1

of Lumbering, Mining and Trading Companies, 30

Preparation, conditions, covenants and execution, 27

Nelson, Mr. Justice; extract from opinion in *Pennock v. Coe*, 47

Newlands, Senator; definition of "unfair methods of competition," 315

New York & Erie Railroad mortgages, 5, 7-10, 12

New York Central Railroad mortgage, 33

New York City

Public Service Commission. *See* Public Service Commission (The)

Rapid Transit Act. *See* Rapid Transit Act

New York Stock Exchange

Rules as to bond issues, 71

Rules as to protective agents, 171

Northern Pacific Railway, mortgage, 12, 33

Noyes, Judge; extract of opinions on Sherman Antitrust Law, 246, 252, 266

Old Dominion Copper Company, reorganization, 226, 227

Papers read

by Byrne, James, 77

by Coleman, George S., 327

by Cravath, Paul D., 153

by Guthrie, William D., 347

by Montague, Gilbert H., 275

by Stetson, Francis Lynde, 1

by Wickersham, George W., 235

Peckham, Justice; extract of opinion on Sherman Antitrust Law, 245

President Wilson; extract of address to Congress on Trade Commission, 276-277

Protective Committees, 162

Prouty, Commissioner; extract from address of, on jurisdiction of Interstate Commerce Commission, 355

Public Service Commission (The N. Y.)

See also Public Service Commissions

See also Public Service Commissions Law

of First District,

Jurisdiction, 333

Organization, departments, etc., 335-336

Method of work, 337-339

Reference to personnel of, in lecture on Public Service Commissions, 357

Jurisdiction and Powers

of First District. *See above*

Reference to, in lecture by William D. Guthrie, 353, 354, 355

of Second District. *See below*

Paper on, by George S. Coleman, 327-346

Reports and opinions, 339

Review of decisions of, 345

of Second District

Jurisdiction, 333

Public Service Commissions

Conditions for usefulness, 347

Duties of commissioners; fewer and simpler, 347-356, 360

Judicial powers, 361-374

New York Public Service Commission.

See Public Service Commission

Paper on, by William D. Guthrie, 347-374

Qualifications of commissioners; expertness, 356-360

Reference to, in lecture on Reorganization of Corporations, 186, 187, 189, 206

Review of rulings, 364-366; 373

Public Service Commissions Law

See also Public Service Commission

Construction; discussion and citation of cases tried under law, 339-345

General provisions, 330-332

History, 327-330

Object of Law, 332, 342

Reference to, in lecture on Reorganization of Corporations, 187

Railroad mortgages, foreclosure, 77

- Rapid Transit Act; jurisdiction of Public Service Commission as to, 333-334
- Recapitalisation, 224
- Receivers
Corporations generally, 157
Railroads, 78, 91, 112
- Reorganisation of Corporations; Bondholders' and Stockholders' Protective Committees; Reorganisation Committees and Voluntary Recapitalisation; Paper by Paul D. Cravath, 153-234
- Reorganisations
Committees, bondholders' and stockholders', 181
- Discussed
American Malt Corporation, 218
Baltimore & Ohio R. R., 177
Metropolitan Traction Co., 231
U. S. Leather Co., 217
U. S. Steel Corporation, 230
Wabash Railroad, 177, 184
Westinghouse Manufacturing & Electric Co., 220
Income bonds, 69
in Insolvency, 156, 208
Recapitalisation, 224
- Richmond & Danville Railroad mortgage, 7
- Richmond & West Point Terminal Railway & Warehouse Company mortgage, 12
- Robinson, Senator; definition of "unfair methods of competition," 316
- Saulsbury, Senator; definition of "unfair methods of competition," 317
- Senate Judiciary Committee; extract of report on Clayton Act, 300
- Sherman Antitrust Law
Contents as originally enacted, abstract of, 240
Criminal Provisions discussed, 272
History of act, 235-239
Objects as explained in debate, 237-239
Paper on; by George W. Wickersham, 235-274
- Stetson, Francis Lynde; paper by, 1-76
- Stevens, Congressman; extract of minority report on Clayton Act, 280
- Stock Exchange Rules
Bond issues, 71
Protective agreements, 171
- Stockholders' Protective Committees, 162
- Storey, Moorfield; extract from address to American Bar Association, 189
- Strong, Mr. Justice; extract from opinion in *Jackson v. Ludeling*, 47
- Taft, Ex-President; extract from address referring to Clayton Act, 299
- Taft, Judge
extract of opinion in *Continental Trust Co.* case, 83
extract of opinion in *Farmers Loan & Trust Co. v. Toledo A. A. & N. M. Ry. Co.*, 128
extract of opinion on *Sherman Antitrust Law*, 244
- Taney, Chief Justice; extract from opinion in *Gue v. Canal Co.*, 47
- Tariff Act, Wilson; section 73 discussed, 295, 296
- Trade Commission and Clayton Act; paper by Gilbert H. Montague, 275-326
- Trading Companies mortgages, 30
- Trustees; provisions concerning, in mortgages, 40, 52, 55
- Unfair methods of Competition. For discussion of phrase in reference to Federal Trade Commission Act, see *Federal Trade Commission Act*
- United States Judicial Code. See *Judicial Code of United States*
- United States Leather Company, reorganisation, 217
- United States Steel Corporation, reorganisation, 230
- Voting Trusts, 208
- Wabash Railroad, reorganisation, 177, 184
- Walsh, Senator; definition of "unfair methods of competition," 317
- Westinghouse Manufacturing and Electric Company, reorganisation, 220
- White, Chief Justice; extract of opinion on *Sherman Antitrust Law*, 254
- Wickersham, George W.; paper by, 235-274
- Williams, Senator; definition of "unfair methods of competition," 317
- Wilson, President; extract of address to Congress on Trade Commission, 276-277
- Wilson Tariff Act; section 73 discussed, 295, 296
- Wyman, Bruce; on public service commissions, 366

CASES CITED OR DISCUSSED

Listed under both title of plaintiff and defendant. Cases in Federal Courts are given under each of these titles without attempting to indicate the moving party in appellate cases, especially when the United States is a party.

- | | |
|---|---|
| <p>A. B. Dick Co., Henry v., 294, 306
 Adams, Broadway Nat'l Bank v., 233
 Adams v. Mercantile Trust Co., 104
 Adams, Millard v., 285
 Adams v. Robinson, 108, 109, 143
 Addyston Pipe & Steel Co. v. United States, 245-247, 258, 272, 297
 Adelbert College, Wabash R. R. v., 82, 104, 145
 Alabama & Georgia Mfg. Co. v. Robinson, 108, 109, 143
 Allen v. Dallas & Wichita R. R., 33
 Allison, Southern Ry. v., 81
 Alsbrook, Wilmington & Welden R. R. v., 286
 Aluminum Co. v. United States, 318, 323
 American Coal Products Co. v. United States, 318, 323
 American Iron Co. v. Seaboard Air Line Ry., 124
 American Loan Co., Kneeland v., 113, 121, 190
 American Malt Corporation v. Board of Public Utility Commissioners, 219
 American Naval Stores Co. v. United States, 318, 323
 American Sugar Refining Co., Penn Sugar Refining Co. v., 245
 American Sugar Refining Co. v. United States, 240
 American Tobacco Co., United States v., 243, 249, 252, 262, 264, 266, 270, 318, 323, 324
 American Tobacco Co., Ware-Kramer Tobacco Co. v., 318, 323
 American Trust Co. v. Metropolitan Steamship Co., 99
 American Waterworks Co., Farmers Loan & Trust Co. v., 115
 American Writing Paper Co., Goodman v., 214
 Appleton Water Works Co. v. Central Trust Co., 104</p> | <p>Arents v. Commonwealth (Va.), 70
 Armour v. United States, 314
 Arms, Kimberly v., 137
 Arnold, Hussey v., 233
 Arnot v. Erie R. R., 70
 Asphalt Co., Gallagher v., 159, 160
 Asphalt Co. of America, Land Title & Trust Co. v., 159
 Atlantic Coast Line, Prentiss v., 339
 Atlantic Trust Co. v. Chapman, 86, 99, 101
 Atlantic Trust Co. v. Dana, 33, 113, 116
 Bailey v. New York Central & H. R. R., 228
 Bank (Nat'l, Newport), Evertson v., 164
 Barnard, Clark v., 81
 Barnard v. Vermont etc. R. R., 228
 Barr v. N. Y., Lake Erie & Western R. R., 225
 Barrow, Shields v., 139
 Barry v. Merchants' Exchange Co., 3
 Batchelder v. C. G. W. Co., 18
 Batterman Co., Odell v., 110
 Bedell, Green v., 284
 Belden v. Burke, 225
 Bergdorf, Matter of, 51, 53
 Bergen, Crawford v., 284
 Bergen v. U. S. Steel Corporation, 230
 Bernheimer v. Converse, 89
 Bigelow, Old Dominion Copper Co. v., 225-227
 Billingham v. Gleason Mfg. Co., 228
 Binghampton Light, Heat & Power Co. v. Stevens, Peo. ex rel., 343
 Black Hawk Gold Mining Co., Carpenter v., 3
 Blair v. City of Chicago, 88
 Blatchford, Phillips v., 233
 Blount Mfg. Co. v. Yale & Towne Mfg. Co., 305
 Blum v. Whitney, 224, 228, 229
 Board of Public Utility Commissioners, American Malt Corporation v., 219</p> |
|---|---|

- Boesch v. Graff, 137
 Booth v. Clark, 89
 Boston, City of, Richardson v., 286
 Bostwick v. Young, 225
 Bosworth v. Hook, 138
 Bowen, Burnham v., 120
 Boyd, Northern Pacific R. R. v., 191, 195-198, 201
 Bradley v. Bradley, 284
 Bray, U. S. Fidelity Co. v., 129
 Bridge Operating Co. v. Public Service Comm., Peo. ex rel., 344
 Brierfield Co., Hollins v., 84
 Broadway Nat'l Bank v. Adams, 233
 Brown, Davis v., 286
 Brown & Gregory Ltd., In re, 164
 Buckeye Powder Co. v. E. I. du Pont de Nemours Powder Co., 302, 318, 323
 Burke, Belden v., 225
 Burnham v. Bowen, 120
 Burroughs Adding Machine Co. v. United States, 319, 323

 Cambria Steel Co., Central Improvement Co. v., 197
 Canada Southern Ry. v. Gebhard, 6
 Canandaigua Academy v. McKechnie, 56
 Carleton, Cragin v., 285
 Carnegie Steel Co., Southern Ry. v., 118, 121, 123, 124
 Carpenter v. Black Hawk Gold Mining Co., 3
 Carrothers, Mason v., 225, 228
 Center, Elliott Machine Co. v., 308
 Central Improvement Co. v. Cambria Steel Co., 197
 Central Lumber Co. v. South Dakota, 296, 318, 323
 Central R. R., Virginia & Alabama Coal Co. v., 123
 Central Trust Co., Appleton Water Works Co. v., 104
 Central Trust Co. v. Chattanooga R. & C. R. Co., 116
 Central Trust Co. v. C. H. V. & T. Ry., 33
 Central Trust Co. v. Chicago & R. I. R. R., 131, 162
 Central Trust Co. v. Cincinnati, H. & D. Ry., 132
 Central Trust Co. v. Grant Locomotive Works, 129
 Central Trust Co., Julian v., 145
 Central Trust Co. v. Madden, 129
 Central Trust Co. v. McGeorge, 84
 Central Trust Co., Wabash, St. Louis & Pacific Ry. v., 85, 86
 Central Trust Co. v. Worcester Cycle Mfg. Co., 105, 106
 Central West Pub. Co. v. United States, 318, 323
 C. G. W. Co., Batchelder v., 18
 C. H. V. & T. Ry., Central Trust Co. v., 33
 Chapman, Atlantic Trust Co. v., 86, 99, 101
 Chattanooga R. & C. R. R. Co., Central Trust Co. v., 116
 Chicago, City of, Blair v., 88
 Chicago & Milwaukee Electric Ry., Investment Registry v., 131, 197
 Chicago & N. W. Ry. v. Whitton, Adm., 81
 Chicago, P. & St. Louis R. R., Mercantile Trust Co. v., 104, 106
 Chicago, R. I. & P. R. R. v. Howard, 70
 Chicago, R. I. & P. R. R., Watson v., 16, 18, 20, 44-46, 72
 Chicago & R. I. R. R., Central Trust Co. v., 131, 162
 Chicago Ry. Equipment Co. v. Merchants National Bank, 17
 Chicago Ry., Merchants Loan & Trust Co. v., 190.
 Chicago, Snell v., 3
 Chicago Terminal Co., United States Trust Co. v., 110
 Chicago & Vincennes Railroad v. Fossdick, 104, 105, 111, 143
 Cincinnati, H. & D. Ry., Central Trust Co. v., 132
 Cincinnati, N. O. & S. Ry., Thomas v., 115
 Citizens' Bank, New Orleans v., 286
 Citizens' St. R. R., City Ry. Co. v., 29
 City Ry. Co. v. Citizens' St. R. R., 29
 Claffin v. Ostrom, 70
 Clark v. Barnard, 81
 Clark, Booth v., 89
 Clarke, France v., 164
 Clark, Hulburt v., 38
 Clark v. Irvin, 284
 Cleland, In re, 88
 Clemes, Hamilton Trust Co. v., 29
 Cleveland etc. R. R., St. Louis etc. R. R. v., 122
 Clum, Eisenlord v., 285
 Clyde v. Richmond & D. R. Co., 128
 Coe, Pennock v., 32, 47
 Cohoes Ry. v. Public Service Comm., Peo. ex rel., 343
 Coleman, Shields v., 145

- Colgate v. U. S. Leather Co., 215, 218
 Colonial Trust Co. v. Wallace, 169
 Coltrane v. Templeton, 78
 Columbus, Hocking Valley etc. Ry.
 v. Lanier, 225
 Commissioners, Memphis & Little
 Rock R. R. v., 33
 Commonwealth (Mass.), v. Horton, 284
 Commonwealth (Virginia), Arents v., 70
 Compton v. Jessup, 32, 83, 104, 110
 Continental Securities Co. v. N. Y.
 Central R. R., 20
 Continental Trust Co., Rhode Island
 Locomotive Works v., 119, 121
 Continental Trust Co. v. Toledo, St.
 L. & K. C. R. R., 83, 93, 110, 116
 Converse, Bernheimer v., 89
 Converse v. Hamilton, 89
 Corn Products Refining Co. v. United
 States, 315
 County of Sac (Iowa), Cromwell v., 286
 Cowdrey, Galveston Railroad v., 116
 Cox v. Stokes, 203
 Cragin v. Carleton, 285
 Cravens, St. Louis Mut. L. Ins. Co. v.,
 285
 Crawford v. Bergen, 284
 Creamery Package Co., Virtue v., 305
 Cream of Wheat Co., Great A. & P.
 Tea Co. v., 299, 302, 303
 Credits Commutation Co. v. United
 States, 130
 Cromwell v. County of Sac (Iowa), 286
 Cudahy Packing Co., Frey & Son v.,
 283
 Curtis v. Leavitt, 3
 Cutting, ex parte, 130

 Dallas & Wichita R. R., Allen v., 33
 Dana, Atlantic Trust Co. v., 33, 113,
 116
 Davis v. Brown, 286
 Davis, Frank v., 44
 Davis v. Schwartz, 139
 Delaware, L. & W. R. R., Troxell v., 286
 Dennison v. United States, 286
 De Sollar v. Hanscome, 286
 D. & H. Co. v. Public Service Comm.,
 Peo. ex rel, 342
 D. & H. Co. v. Stevens (Publ. Ser.
 Comm.) Peo. ex rel., 343
 (A. B.) Dick Co., Henry v., 294, 306
 Dickerman v. N. Trust Co., 88
 Diggs v. Fidelity Co., 51
 D. L. & W. R. R. v. United States, 312
 Dow, Memphis & Little Rock R. R. v.,
 186
 Dow v. Memphis & S. R. R., 33, 116
 Dows, Muller v., 81
 Drayton, Haehulen v., 115
 Drexell, Lake Superior Iron Co. v., 214
 Dry Dock etc. R. R., v. Public Service
 Commission, Peo. ex rel., 344
 Duncan, Ketchum v., 43
 Dumpor's Case, 42
 Dunlop v. Mulry, 31
 (E. I.) du Pont de Nemours Powder
 Co., Buckeye Powder Co. v., 302,
 318, 323
 Eastern States Retail Lumber Dealers
 Association v. United States, 298,
 319, 323
 Eastman Kodak Co. v. United States,
 271
 East Tennessee, V. & G. Ry., Toler v.,
 111
 Eisenlord v. Clum, 285
 Elgin Board of Trade v. United States,
 319, 323
 Elliott Machine Co. v. Center, 308
 Ellis v. Jameson, 285
 Enterprise Transportation Co., Whelan
 v., 123
 Equitable Trust Co. v. United Box
 Board & Paper Co., 197
 Erie R. R., Arnot v., 70
 Erie Ry., Woodruff v., 101
 Ettlinger v. Persian Rug & C. Co., 46
 Evening Post Co., Knott v., 104
 Everson v. Gere, 70
 Everton v. National Bank, Newport,
 164

 Fairmont Creamery Co., State (Iowa)
 v., 318
 Farmers Loan & Trust Co. v. American
 Waterworks Co., 115
 Farmers Loan & Trust Co., Lacka-
 wanna Iron & Coal Co. v., 118
 Farmers Loan & Trust Co. v. Lake
 Street Elevated Ry. Co., 104, 157
 Farmers Loan & Trust Co. et al., v.
 Louisville, N. A. & C. Ry. et al., 191
 Farmers Loan & Trust Co. v. Northern
 Pac. R. R., 90, 102, 128
 Farmers Loan & Trust Co., Rhine-
 lander v., 26, 52, 55
 Farmers Loan & Trust Co. v. Toledo
 A. A. & N. M. Ry., 128, 135
 Fidelity Co., Diggs v., 51
 First National Bank, Cleveland, v.
 Shedd, 205
 Fitchburg R. R., Polhemus v., 32
 Flint & P. M. R. R., Mackintosh v., 70

- Fordyce v. Omaha, K. C. & E. R. R., 138
 Fosdick, Chicago & Vincennes Railroad v., 104, 105, 111, 143
 Fosdick v. Schall, 118, 121
 Fowler v. Jarvis-Conklin Mortgage Co., 173
 Fox, Lawrence v., 48
 France v. Clarke, 164
 Frank v. Davis, 44
 Frey & Son v. Cudahy Packing Co., 283
 Friedman's Saving Co. v. Shepherd, 116
 Frink, McComb v., 286
 French v. Gapin, 126
 Frost v. Thompson, 233
 Furey, Keasley v., 89

 Gallagher v. Asphalt Co. of America, 159, 160
 Galveston Railroad v. Cowdrey, 116
 Gamble v. Queens Co. Water Co., 215
 Gapin, French v., 126
 Gebhard, Canada Southern Ry. v., 6
 General Electric Co. v. United States, 318, 323
 Gere, Everson v., 70
 Gleason Mfg. Co., Billingham v., 228
 Goodman v. American Writing Paper Co., 214
 Goodwin v. Roberts, 164
 Goy & Co. Ltd., In re, 164
 Graff, Boesch v., 137
 Grant v. Winona & S. W. Ry., 44
 Grant Locomotive Works, Central Trust Co. v., 129
 Great A. & P. Tea Co. v. Cream of Wheat Co., 299, 302, 303
 Great Lakes Towing Co. v. United States, 269
 Great Western Mining Co. v. Harris, 89
 Great Western Ry., Hoole v., 228
 Green v. Bedell, 284
 Greene Cove Co., Guaranty Trust Co. v., 107
 Greene, In re, 318
 Gregg v. Metropolitan Trust Co., 122, 124
 Grenada Lumber Co. v. Mississippi, 296
 Guarantee Trust Co., Wood v., 43
 Guaranty Trust Co. v. Greene Cove Co., 107
 Guaranty Trust Co. v. International Steam Pump Co., 98, 158
 Guaranty Trust Co., N. Y. v. International Typesetting Machine Co., 189
 Guaranty Trust Co., N. Y. v. Metropolitan St. Ry., 143, 151
 Gubner v. McClellan, 340
 Gue v. Tide Water Canal Co., 3, 47
 Guilford v. Minneapolis & C. Ry., 16

 Haehulen v. Drayton, 115
 Haight v. Pittsburg & C. R. R., 19
 Hale v. Henkel, 314
 Hamburg-Amerikanische Packetfahrt Actien & Gesellschaft v. United States, 319, 323
 Hamilton, Converse v., 89
 Hamilton, Vail v., 29
 Hamilton Trust Co. v. Clemes, 29
 Hanscome, De Sollar v., 286
 Harnickell v. Omaha Water Co., 64
 Harriman v. Interstate Commerce Commission, 314
 Harris v. Great Western Mining Co., 89
 Hartwell R. Co., Linder v., 46
 Hasbrouck (Metropolitan St. Ry. Co.), People v., 103
 Hayes, Parsons v., 225
 Henkel, Hale v., 314
 Henry v. A. B. Dick Co., 294, 306
 High Ct. of F., Schreiner v., 284
 Hocking Valley R. R. v. N. Y. Coal Co., 312
 Hollins v. Brierfield Co., 84
 Holmes v. Willard, 70
 Hook, Bosworth v., 138
 Hoole v. Great Western Ry., 228
 Horn v. Pere Marquette R. R., 84, 89, 91-93
 Horton, Commonwealth (Mass.) v., 284
 Howard, Chicago, R. I. & P. R. R. v., 70
 Howe v. Morse, 233
 Howell, In re, 197
 Howell, Mechanics & Metals Nat. Bank v., 197
 Howell v. Western R. R., 104, 111.
 Hulbert v. Clark, 38
 Humphreys, Quincy M. & P. Co. v., 86, 101, 103
 Huron Copper Mining Co., Jellinek v., 78
 Hussey v. Arnold, 233
 Hyde, Krippendorf v., 127.

 Illinois Midland Co., Union Trust Co. v., 99, 100
 Industrial & Trust Co. v. Todd, 169, 203

- International Harvester Co. v. Missouri, 296
 International Harvester Co. v. United States, 253, 256
 International Mercantile Marine Receivership, 159
 International Steam Pump Co., Guaranty Trust Co. v., 98, 158
 International Steam Pump Co., Receivership, 159
 International Typesetting Machine Co., Guaranty Trust Co. v., 189
 Interstate Commerce Commission, Harriman v., 314
 Investment Registry v. Chicago & Milwaukee Electric Ry., 131, 197
 Iron Railway Co., Robinson v., 205
 Irvin, Clark v., 284
 Irvine v. N. Y. Edison Co., 51

 Jackson v. Ludeling, 47
 Jackson, Parsons v., 19
 Jameson, Ellis v., 285
 Jarvis-Conklin Mortgage Co., Fowler v., 173
 Jellicoe Mountain Coal & Coke Co. v. U. S., 271
 Jellinek v. Huron Copper Mining Co., 78
 Jessup, Compton v., 32, 83, 104, 110
 Joint Traffic Association Cases, 243, 272, 297
 Joline v. Willcox (Pub. Ser. Comm.) Peo. ex rel., 339
 Julian v. Central Trust Co., 145
 Ju Toy v. United States, 363

 Kanawha & O. Ry., Mercantile Trust Co. v., 78
 Kansas City Ry. Co., State Trust Co. v., 104
 Kansas, Smiley v., 297
 Keatley v. Furey, 89
 Keech v. Stowe-Fuller Co., 197
 Kent v. Quicksilver Mining Co., 215, 225
 Keokuk & Western R. R. v. Missouri, 286
 Ketchum v. Duncan, 43
 Keystone Watch Co. v. United States, 268, 318, 323
 Kidansky, Robert v., 45
 Kimberly v. Arms, 137
 Kings Co. Lighting Co. v. Willcox (Pub. Serv. Comm.) Peo. ex rel., 344, 373
 Kirven, Virginia-Carolina Chemical Co. v., 286

 Kneeland v. American Loan Co., 113, 121, 190
 Knight v. United States, 243-245
 Knott v. Evening Post Co., 104
 Kohn v. McNulta, 128
 Krippendorf v. Hyde, 127

 Lackawanna Iron & Coal Co. v. Farmers Loan & Trust Co., 118
 Lafayette etc. Ry., Rosen-Kraus v., 18
 Lake Street Elevated Ry. Co., Farmers Loan & Trust Co. v., 104, 157
 Lake Superior Iron Co. v. Drexel, 214
 Land Title & Trust Co. v. Asphalt Co., 159
 Lander v. Mercantile Bank, 286
 Lanier, Columbus, Hocking Valley etc. Ry. v., 225
 Lansing, Stewart v., 286
 Lary, Wood v., 228
 Lawlor, Loewe v., 291
 Lawrence v. Fox, 48
 Leavitt, Curtis v., 3
 Lee, Noonan v., 44
 Lehigh Valley R. R. v. United States, 312
 Lewisohn, Old Dominion Copper Co. v., 226, 227, 229
 Linder v. Hartwell R. Co., 46
 Little, Wilson v., 11
 L. N. E. & St. Louis Consol. Ry., N. Y. Security v., 32
 Loewe v. Lawlor, 291
 Logan County Bank v. Townsend, 29
 Logansport Ry., Miltenberger v., 122
 Lord v. Yonkers Fuel Gas Co., 32
 Louisville, N. A. & C. Ry., et al., Farmers Loan & Trust Co. v., 191
 Louisville N. A. & C. Ry. v. Louisville Trust Co., 29, 191, 194, 197
 Louisville Trust Co., Louisville N. A. & C. Ry. v., 29, 191, 194, 197
 Lowry, Montague & Co. v., 297
 Ludeling, Jackson v., 47

 Maas v. Mo. Kan. & Texas Ry., 17
 Mackay v. Randolph, 44
 Mackintosh v. Flint & P. M. R. R., 70
 Madden, Central Trust Co. v., 129
 Mallory v. W. S. R. R., 18, 42
 Mandel, In re, 344
 Mason v. Carrothers, 225, 228
 Masten, Minot v., 110
 Matter of Bergdorf, 51, 53
 Matter of Public Service Commission (In re Mandel), 344

- Mayer v. Metropolitan Traction Co., 225
 Mayo v. Morits, 233
 McClellan, Gubner v., 340
 McClelland v. Norfolk & Southern R. R., 16
 McComb v. Frink, 286
 McGeorge, Central Trust Co. v., 84
 McKechnie, Canandaigua Academy v., 56
 McLeod v. City of New Albany, 129
 McLish v. Roff, 129
 McNulta, Kohn v., 128
 Mechanics & Metals Nat. Bank v. Howell, 197
 Memphis & Little Rock R. R. v. Commissioners, 33
 Memphis & Little Rock R. R. v. Dow, 186
 Memphis & Little Rock R. R., Sage v., 116
 Memphis & S. R. R., Dow v., 33, 116
 Mercantile Bank, Lander v., 286
 Mercantile Trust Co., Adams v., 104
 Mercantile Trust Co. v. Chicago P. & St. L. R. R., 104, 106
 Mercantile Trust Co. v. Kanawha & O. Ry., 78
 Merchants' Exchange Co., Barry v., 3
 Merchants Loan & Trust Co. v. Chicago Ry., 190
 Merchants National Bank, Chicago Ry. Equipment Co. v., 17
 Merriam v. Ross, Peo. ex rel., 85
 Metropolitan Ry. Receivership, In re, 86, 103, 162
 Metropolitan Steamship Co., American Trust Co. v., 99
 Metropolitan St. Ry., Guaranty Trust Co. v., 143, 151
 Metropolitan Traction Co., Mayer v., 225
 Metropolitan Trust Co., Gregg v., 122, 124
 Millard v. Adams, 285
 Mills, Windsor v., 232
 Miltenberger v. Logansport Ry., 122
 Milton, Williams v., 233
 Minneapolis etc. Ry., Guilford v., 16
 Minnesota v. Northern Securities Co., 288
 Minnesota Rate Cases, 373
 Minot v. Masten, 110
 M. K. & T. Ry. v. Union Trust Co., 64
 Mississippi, Grenada Lumber Co. v., 296
 Missouri, International Harvester Co. v., 296
 Missouri, Keokuk & Western R. R. v., 286
 Missouri Rate Cases, 373
 Mo. Kan. & Texas Ry., Maas v., 17
 Monon Cases, 29, 191, 194, 197
 Montague & Co. v. Lowry, 297
 Morgan's Co. v. Texas Central Ry., 43, 45, 83, 104, 105, 109
 Morgan, Williams v., 130
 Morits, Mayo v., 233
 Morse, Howe v., 233
 Motion Picture Patents Co. v. United States, 272
 Muller v. Dows, 81
 Mulry, Dunlop v., 31
 Nash v. United States, 250, 273, 298, 323.
 National Association, Retail Druggists v. United States, 318, 323
 National Bank, Newport, Evertson v., 164
 National Cash Register Case, 273, 302, 318
 National Cotton Oil Co. v. Texas, 297
 National Wholesale Jewelers Association v. United States, 319, 323
 Nesbit v. Riverside Independent District, 286
 New Albany, City of, McLeod v., 129
 New Departure Mfg. Co. v. United States, 319, 323
 New Orleans v. Citizens' Bank, 286
 New York Car Wheel Wks., In re, 70
 New York Central & H. R. R., Bailey v., 228
 New York Central R. R., Continental Securities Co. v., 20
 New York Central R. R., Switzerland Co. v., 37
 New York City Ry., Penn Steel Co. v., 101, 113, 119, 123, 124, 162
 New York Coal Co., Hocking Valley R. R. v., 312
 New York Edison Co., Irvine v., 51
 New York Edison Co. v. Willcox, (Pub. Serv. Comm.) Peo. ex rel., 344
 New York, L. E. & W. R. R., Barr v., 225
 New York, L. E. & W. R. R., New York, P. & O. R. R. v., 78
 New York, N. H. & Hartford R. R. v. Willcox (Pub. Serv. Comm.) Peo. ex rel., 341

- New York, P. & O. R. R. v. New York, L. E. & W. R. R., 78
 New York & Queens Co. Ry., Public Service Commission v., 344
 New York Railways, Public Service Comm. v., 344
 New York Security v. L. N. E. & St. L. Consol. Ry., 32
 Nome Retail Grocers' Association v. United States, 318, 323
 Noonan v. Lee, 44
 Norfolk & Southern R. R., McClelland v., 16
 North Carolina R. R. v. Swasey, 137
 Northern Pacific R. R. v. Boyd, 191, 195-198, 201
 Northern Pacific R. R., Farmers Loan & Trust Co. v., 90, 102, 128
 Northern Pacific Ry. v. Parker, 30
 Northern Pacific Ry., Paton v., 192
 Northern Securities Co., Minnesota v., 288
 Northern Securities Co. v. United States, 247, 251, 259, 269, 272, 298
 N. Trust Co., Dickerman v., 88
 Northrop, Stillman v., 70

 Odell v. Batterman Co., 110
 Odessa Waterworks Co., Wood v., 228
 Olcott v. Tioga R. R., 70
 Old Dominion Copper Co. v. Bigelow, 225-227
 Old Dominion Copper Co. v. Lewisohn, 226, 227, 229
 Omaha, K. C. & E. R. R., Fordyce v., 138
 Omaha Water Co., Harnickell v., 64
 Omaha Water Co., U. S. Water Works Co. Ltd. v., 165, 203
 Ostrom, Claflin v., 70

 Pacific Coast Plumbing Supply Association v. United States, 319, 323
 Parker, N. O. Pac. Ry. v., 30
 Parkinson v. West End Ry., 18
 Parsons v. Hayes, 225
 Parsons v. Jackson, 19
 Paton v. Northern Pacific Ry., 192
 Patten v. United States, 298
 Patterson v. United States, 273, 302, 318
 Pennock v. Coe, 32, 47
 Pennsylvania Steel Co. v. N. Y. City Ry., 101, 113, 119, 123, 124, 162
 Pennsylvania Sugar Refining Co. v. American Sugar Refining Co., 245
 Peo. v. Hasbrouck (Metropolitan St. Ry. Co., 103
 Peo. ex rel. Binghampton Light, Heat & Power Co. v. Stevens, 343
 Peo. ex rel. Bridge Operating Co. v. Public Service Commission, 344
 Peo. ex rel. Cohoes Ry. v. Public Service Comm., 343
 Peo. ex rel. D. & H. Co. v. Public Service Comm., 342
 Peo. ex rel. D. & H. Co. v. Stevens (Pub. Serv. Comm.), 343
 Peo. ex rel. Dry Dock etc. R. R. v. Public Service Comm., 344
 Peo. ex rel. Joline v. Willcox (Public Service Comm.), 339
 Peo. ex rel. King's County Lighting Co. v. Willcox (Pub. Serv. Comm.), 344, 373
 Peo. ex rel. Merriam v. Ross, 85
 Peo. ex rel. N. Y. Edison Co. v. Willcox (Pub. Serv. Comm.), 344
 Peo. ex rel. N. Y. N. H. & Hartford R. R. v. Public Service Commission, 341
 Peo. ex rel. South Shore Traction Co. v. Willcox (Pub. Serv. Comm.), 340
 Peo. ex rel. Ulster & Delaware R. R. v. Public Service Comm., 344
 Père Marquette R. R., Horn v., 84, 89, 91-93
 Persian Rug etc. Co., Ettlinger v., 46
 Philadelphia Jobbing Confectioners' Association v. United States, 319, 323
 Phillips v. Blatchford, 233
 Pittsburgh etc. R. R., Haight v., 19
 Place, Russell v., 286
 Polhemus v. Fitchburg R. R., 32
 Powder Trust Case, 249, 268
 Prentis v. Atlantic Coast Line, 339
 Pronick v. Spirits Distributing Co., 215
 Public Service Commission (Stevens), Binghampton Light, Heat & P. Co. v., Peo. ex rel., 343
 Public Service Commission, Bridge Operating Co. v., Peo. ex rel., 344
 Public Service Commission (Stevens), D. & H. Co. v., Peo. ex rel., 343
 Public Service Commission, Cohoes Ry. v., Peo. ex rel., 343
 Public Service Commission, D. & H. Co. v., Peo. ex rel., 342
 Public Service Commission, Dry Dock etc. R. R. v., Peo. ex rel., 344
 Public Service Commission, Matter of (Mandel), 344
 Public Service Commission v. N. Y. & Queens Co. Ry., 344
 Public Service Commission v. N. Y. Rys., 344

- Public Service Commission, Ulster & Delaware R. R. v., Peo. ex rel., 344
 Public Service Commission v. Westchester Street R. R., 343
 Public Service Commission (Willcox), Joline v., Peo. ex rel., 339
 Public Service Commission (Willcox), Kings Co. Lighting Co. v., Peo. ex rel., 344, 373
 Public Service Commission (Willcox), N. Y. Edison Co. v., Peo. ex rel., 344
 Public Service Commission (Willcox), N. Y., N. H. & Hartford v., Peo. ex rel., 341
 Public Service Commission (Willcox) v. South Shore Traction Co., Peo. ex rel., 340
 Pursell, Riggs v., 31
 Queens Co. Water Co., Gamble v., 215
 Quicksilver Mining Co., Kent v., 215, 225
 Quincy M. & P. Co. v. Humphreys, 86, 101, 103
 Railroad Co. v. Bailey, 228
 Railroad Co. v. Fordyce, 138
 Railroad Co. v. Howard, 70
 Railroad Co. v. Thomas, 124
 Railway Co. v. Whitton, 81
 Randolph, Mackay v., 44
 Reading Co. v. United States, 270, 298, 312
 Rhinelander v. Farmers Loan & Trust Co., 26, 52, 55
 Rhode Island Locomotive Works v. Continental Trust Co., 119, 121
 Richardson v. City of Boston, 286
 Richmond & D. R. Co., Clyde v., 128
 Richmond Light & R. R. Co., Willcox v., 342, 343
 Riggs v. Pursell, 31
 Riley, St. Louis Trust Co. v., 119
 Riverside Independent District, Nesbit v., 286
 Robert v. Kidansky, 45
 Roberts, Goodwin v., 164
 Robinson, Adams v., 108, 109, 143
 Robinson, Alabama & G. Mfg. Co. v., 108, 109, 143
 Robinson v. Iron Ry., 205
 Roff, McLish v., 129
 Rogers etc. v. Southern R. Association, 70
 Romodka Co., In re, 70
 Rosenkrans v. Lafayette etc. Ry., 18
 Roes, Merriam v., State (Mo.) ex rel., 85
 Russell v. Place, 286
 Sac, County of (Iowa) v. Cromwell, 286
 Sage v. Memphis & Little Rock R. R., 116
 St. Louis Mut. L. Ins. Co. v. Cravens, 285
 St. Louis etc. R. R. v. Cleveland etc. R. R., 122
 St. Louis Terminal Case, 270, 272
 St. Louis Trust Co. v. Riley, 119
 Sampson, Wiswell v., 110
 Schall, Fosdick v., 118, 121
 Schreiner v. High Ct. of F., 284
 Schreyer, Vanderbilt v., 45
 Schwartz, Davis v., 139
 Seaboard Air Line Ry., American Iron Co. v., 124
 Seymour v. Spring Forest Cemetery Association, 224, 225
 Shedd, First National Bank, Cleveland v., 205
 Shepherd, Friedman's Saving Co. v., 116
 Shields v. Barrow, 139
 Shields v. Coleman, 145
 Sickles, Washington A. & G. Steam Packet v., 286
 Smiley v. Kansas, 297
 Snell v. Chicago, 3
 Southard v. Southard, 232
 South Dakota, Central Lumber Co. v., 296, 318, 323
 Southern Pacific R. R. Co. v. United States, 261, 285, 286
 Southern Ry. v. Allison, 81
 Southern Ry. v. Carnegie Steel Co., 118, 121, 123, 124
 Southern R. Association, Rogers etc. v., 70
 Southern Wholesale Grocers' Association v. United States, 319, 323
 South Shore Traction Co. v. Willcox (Pub. Serv. Comm.), Peo. ex rel., 340
 Sperry, Jones & Co., Tompkins v., 225
 Spirits Distributing Co., Pronick v., 215
 Spring Forest Cemetery Association, Seymour v., 224, 225
 Standard Co., Windmuller v., 70
 Standard Oil Co. v. United States, 243, 249, 252, 254, 258, 260, 270, 318, 323, 324
 Standard Sanitary Mfg. Co. v. United States, 305, 319, 323
 Standard Wood Co. v. United States, 319, 323

- State (Iowa) v. Fairmont Creamery Co., 318
 State (Mo.) ex rel. Merriam v. Ross, 85
 State Trust Co. v. Kansas City Ry. Co., 104
 Stevens (Pub. Serv. Comm.), Bing-hamton Light, Heat & Power Co. v., Peo. ex rel., 343
 Stewart v. Lansing, 286
 Stillman v. Northrop, 70
 Stokes, Cox v., 203
 Stoneburner, Universal Savings & Trust Co. v., 92
 Stone v. United States, 286
 Stowe-Fuller Co., Keech v., 197
 Swann v. Wright's Executor, 145
 Swasey, North Carolina R. R. v., 137
 Switzerland Co. v. N. Y. Central R. R., 37
 Syracuse etc. R. R., In re, 225

 Templeton, Coltrane v., 78
 Terminal Ry. Association v. United States, 243, 270, 272
 Texas Central Ry., Morgan's Co. v., 43, 45, 83, 104, 105, 109
 Texas, National Cotton Oil Co. v., 297
 Texas, Waters-Pierce Oil Co. v., 297
 Third Avenue Ry. Case, 188
 Thomas v. Cincinnati, N. O. & S. Ry., 115
 Thomas v. Western Car Co., 124
 Thompson, Frost v., 233
 Tide Water Canal Co., Gue v., 3, 47
 Tioga R. R., Olcott v., 70
 Titus v. United States Smelting, Re-fining & Mining Exploration Co., 166
 Todd, Industrial & Trust Co. v., 169, 203
 Toledo, A. A. & N. M. Ry., Farmers Loan & Trust Co. v., 128, 135
 Toledo, St. L. & K. C. R. R., Con-tinental Trust Co. v., 83, 93, 110, 116
 Toler v. East Tennessee, V. & G. Ry., 111
 Tompkins v. Sperry, Jones & Co., 225
 Townsend, Logan County Bank v., 29
 Trans-Missouri Freight Association v. United States, 243
 Troy, City of, v. United Traction Co., 341
 Troxell v. Delaware, L. & W. R. R., 286

 Ulster & Delaware R. R. Co. v. Pub. Serv. Comm. Peo. ex el., 344
 Union Pacific R. R. v. United States, 250, 258, 261, 262, 269, 270, 272
 Union Trust Co. v. Illinois Midland Co., 99, 100
 Union Trust Co., M. K. & T. Ry. v., 64
 United Box Board & Paper Co., Equi-table Trust Co. v., 197
 United Shoe Mfg. Co. v. United States, 305, 306, 309
 United States v. Addyston Pipe & Steel Co., 245, 258, 272, 297
 United States v. Aluminium Co., 318, 323
 United States v. American Coal Prod-ucts Co., 318, 323
 United States v. American Naval Stores Co., 318, 323
 United States v. American Sugar Re-fining Company, 240
 United States v. American Tobacco Co., 243, 249, 252, 262, 264, 266, 270, 318, 323, 324
 United States v. Armour, 314
 United States v. Burroughs Adding Machine Co., 319, 323
 United States v. Central West Pub. Co., 318, 323
 United States v. Corn Products Re-fining Co., 315
 United States v. Credits Commutation Co., 130
 United States v. Dennison, 286
 United States v. D. L. & W. R. R. Co., 312
 United States v. Eastern States Retail Lumber Dealers' Association, 298, 319, 323
 United States v. Eastman Kodak Co., 271
 United States v. Elgin Board of Trade, 319, 323
 United States v. General Electric Co., 318, 323
 United States v. Great Lakes Towing Co., 269
 United States v. Hamburg-Ameri-kanische Packetfahrt Actien Gesellschaft, 319, 323
 United States v. International Har-vester Co., 253, 256
 United States v. Jellicoe Mountain Coal & Coke Co., 271
 United States v. Joint Traffic Asso., 243, 272
 United States v. Ju Toy, 363
 United States v. Keystone Watch Co., 268, 318, 323
 United States v. Knight, 243-245
 United States v. Lehigh Valley R. R., 312

- United States v. Motion Picture Patents Co., 272
 United States v. Nash, 250, 273, 298, 323
 United States v. National Association Retail Druggists, 318, 323
 United States v. National Cash Register Company, 273, 302, 318
 United States v. National Wholesale Jewellers' Association, 319, 323
 United States v. New Departure Mfg. Co., 319, 323
 United States v. Nome Retail Grocers' Association, 318, 323
 United States v. Northern Securities Co., 247, 251, 259, 269, 272, 298
 United States v. Pacific Coast Plumbing Supply Association, 319, 323
 United States v. Patten, 298
 United States v. Patterson, 273, 302, 318
 United States v. Philadelphia Jobbing Confectioners' Association, 319, 323
 United States v. Powder Trust, 249, 268
 United States v. Reading Co., 270, 298, 312
 United States v. Southern Pacific R. R. Co., 261, 285, 286
 United States v. Southern Wholesale Grocers' Association, 319, 323
 United States v. Standard Oil Co., 243, 249, 252, 254, 258, 260, 270, 318, 323, 324
 United States v. Standard Sanitary Mfg. Co., 305, 319, 323
 United States v. Standard Wood Co., 319, 323
 United States v. Stone, 286
 United States v. Terminal Ry. Association, 243, 270, 272
 United States v. Trans-Missouri Freight Association, 243
 United States v. Union Pacific R. R., 250, 258, 261, 262, 269, 270, 272
 United States v. United Shoe Mfg. Co., 305, 306, 309
 United States v. United States Machinery Co., 289, 290
 United States v. United States Steel Corporation, 253, 254, 268
 United States v. Winslow, 305
 United States Fidelity Co. v. Bray, 129
 United States Leather Co., Colgate v., 215, 218
 United States Machinery Co. v. United States, 289, 290
 U. S. & Mex. Trust Co., Western Union Co. v., 110, 197
 U. S. Smelting, Refining & Mining Exploration Co., Titus v., 166
 U. S. Steel Corporation, Bergen v., 230
 U. S. Steel Corporation v. United States, 253, 254, 268
 U. S. Trust Co. v. Chicago Terminal Co., 110
 U. S. Trust Co. v. Wabash, 115
 U. S. Water Works Co. Ltd. v. Omaha Water Co., 165, 203
 Universal Savings & Trust Co. v. Stoneburner, 92
 United Traction Co., Troy, City of, v., 341
 Utica Bank, Yates v., 286
 Vail v. Hamilton, 29
 Vanderbilt v. Schreyer, 45
 Vermont etc. R. R., Barnard v., 228
 (the) Vigilancia, 29
 Virginia & Alabama Coal Co. v. Central R. R., 123
 Virginia-Carolina Chemical Co. v. Kirven, 286
 Virtue v. Creamery Package Co., 305
 Wabash R. R. v. Adelbert College, 82, 104, 245
 Wabash, St. Louis & Pacific Ry. v. Central Trust Co., 85, 86
 Wabash, United States Trust Co. v., 115
 Wallace, Colonial Trust Co. v., 169
 Ware-Kramer Tobacco v. American Tobacco Co., 318, 323
 Washington, A. & G. Steam Packet Co. v. Sickles, 286
 Waters-Pierce Oil Co. v. Texas, 297
 Watson v. Chicago, Rock Island & Pacific R. R., 16, 18, 20, 44-46, 72
 Wenner, West Shore R. R. v., 31
 Westchester Street R. R., Public Service Commission v., 343
 West End Ry., Parkinson v., 18
 Western Car Co., Thomas v., 124
 Western R. R., Howell v., 104, 111
 Western Union Co. v. U. S. & Mex. Trust Co., 110, 197
 West Shore R. R., Mallory v., 18, 42
 West Shore R. R. v. Wenner, 31
 Whelan v. Enterprise Transportation Co., 123
 Whitney, Blum v., 224, 228, 229
 Whitton, Admr., Chicago & Northwestern Ry. v., 81

- | | |
|--|--|
| Willard, Holmes v., 70 | Winona & S. W. Ry., Grant v., 44 |
| Willcox (Pub. Serv. Comm.), New York, N. H. Hartford R. R. v., Peo. ex rel., 341 | Winslow v. United States, 305 |
| Willcox (Pub. Serv. Comm.), New York Edison Co. v., 344 | Winter, Wilson v., 109 |
| Willcox (Pub. Serv. Comm.) v. Richmond Light & R. R., 342, 343 | Wiswell v. Sampson, 110 |
| Willcox (Publ. Serv. Comm.), South Shore Traction Co. v., Peo. ex rel., 340 | Wood v. Guarantee Trust Co., 43 |
| Williams v. Milton, 233 | Wood v. Lary, 228 |
| Williams v. Morgan, 130 | Wood v. Odeesa Waterworks Co., 228 |
| Wilmington & Weldon R. R. v. Alsbrook, 286 | Woodruff v. Erie Ry., 101 |
| Wilson v. Little, 11 | Worcester Cycle Mfg. Co., Central Trust Co. v., 105, 106 |
| Wilson v. Winter, 109 | Wright's Executor, Swan v., 145 |
| Windmuller v. Standard Co., 70 | W. S. R. R., Mallory v., 18, 42 |
| Winsor v. Mills, 232 | |
| | Yale & Towner Mfg. Co., Blount Mfg. Co. v., 305 |
| | Yates v. Utica Bank, 286 |
| | Yonkers Fuel Gas Co., Lord v., 32 |
| | Young, Bostwick v., 225 |

THE following pages contain advertisements of a
few of the Macmillan books on kindred subjects

Law and Order in Industry

By JULIUS HENRY COHEN

Cloth, 12mo, \$1.50

A lawyer who knows the facts of the case from intimate knowledge gives in this book a comprehensive story of the "Protocol" experiences in the cloak and suit industry of New York. He describes vividly the processes and results of collective dealing between a trades union and an employers' association covering a period of five years. The solution of the apparently baffling problems furnishes lessons of great immediate and future import to all employers of labor, trades unionists, social reformers and students of political science and economics.

"The book is a distinct contribution to the science of social relations and as such should have a wide reading both here and abroad." — *The Independent*.

"His book is a sound and reliable study of a small, but significant, phase of a world-wide movement."

— *Boston Daily Advertiser*.

THE MACMILLAN COMPANY

Publishers

64-66 Fifth Avenue

New York

Voting Trusts: Chapters in Recent Corporate History

By HARRY A. CUSHING

Of the New York Bar

Cloth, 8vo, \$1.50

This is a concisely written volume of real interest to investigators and business men as well as to trust company officials and lawyers. It is the first book on the subject and covers the early history of voting trusts and the details of their more recent development. The facts have been gathered and collated with substantial thoroughness as illustrations of the discussion under the three heads of the significance, the contents, and the law of voting trusts. A selection of important documents is also included.

"This is a book on a modern development of corporate law written by one who shows an intimate acquaintance with present commercial methods and with recent history of corporate management. Mr. Cushing's literary style is excellent, his citation of authorities is exhaustive, and he has given in compact form a clear and illuminating statement of the law of voting trusts not elsewhere to be found."

— *Harvard Law Review.*

"The first adequate treatise on that modern development in the direction of corporate activity."

— *Journal of Commerce and Commercial Bulletin.*

THE MACMILLAN COMPANY

Publishers 64-66 Fifth Avenue New York

A History of Currency in the United States

By A. BARTON HEPBURN, LL.D.

Chairman of the Board of Directors of the Chase National Bank, formerly
Comptroller of the Currency, ex-Superintendent of Banks of the State
of New York, ex-President of the New York Chamber of Commerce
and ex-President of the New York Clearing House

New edition, cloth, 8vo, \$2.50

The purpose of this volume is to place before the public all the essential facts as to currency, coinage and banking, from the wampumpeage of the colonies to the notes of our Federal Reserve Banks as well as the indispensable political history connected therewith.

"Nobody who follows financial subjects can afford to be without this book . . . libraries ought to have it, men of business should study it, and would find pleasure in doing so, many legislators are in especial need of reading, learning, and inwardly digesting it." — *New York Times*.

"No more authoritative work upon the currency of the United States ever has been issued than that written by A. Barton Hepburn . . . the book should be carefully read by every banker or other persons interested in finance."

— *Boston Herald*.

THE MACMILLAN COMPANY

Publishers 64-66 Fifth Avenue New York

Day in Court

By FRANCIS L. WELLMAN

Cloth, gilt top, 258 pp., 8vo, \$2.00

This book will give to the general reader and to young men who desire to become successful advocates a practical knowledge of the art of great advocates in eliciting the truth, indicating the methods by which they charm and convince both court and jury and win them over to their side of the controversy. The work is filled with the hints and suggestions which have been derived from the author's experience of many years in the courts and with many concrete examples and illustrative materials.

"An excellent and most entertaining book."—*New York Post*.

"An excellent book for young lawyers to read."—*The Outlook*.

The Art of Cross-Examination

With some cross-examinations of important witnesses in some celebrated cases.

By FRANCIS L. WELLMAN

Cloth, 8vo, 404 pp., \$2.50

OPINIONS OF THE PRESS

"Mr. Wellman understands his subject thoroughly, there can be no question. Those looking to perfect themselves in the art of cross-examination can hardly do better than to make a study of this book."

—*Chicago Tribune*.

"It is not often that a book, written on so technical a subject as this most subtle branch of the advocate's art, possesses so much genuine interest for the thinking reader. There is scarcely a business man of good intelligence anywhere, who would not find 'The Art of Cross-Examination' as fascinating as a novel."—*Brooklyn Daily Eagle*.

THE MACMILLAN COMPANY

Publishers 64-66 Fifth Avenue New York

STANFORD UNIVERSITY LIBRA

To avoid fine, this book should be ret
or before the date last stamped

7 12 1935

STANFORD UNIVERSITY LAW LIBRARY

CT ASQ TG

Some legal phases of corporate

Stanford Law Library



3 6105 044 206 659

